Supreme Court, U.S.
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In The

Supreme Court of the United States

MICHAEL FREDERICK SIEGEL,

Petitioner,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The District Of Columbia Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

The Securities and Exchange Commission reviews a self-regulatory organization's discipline of a member by assessing the SRO record anew – even those material issues and errors the parties before it left unaddressed – then enters its own findings of fact and conclusions of law. Once the SEC reviews the facts and law presented in the SRO record and renders its autonomous decision, should a court of appeals entertain arguments made for the first time in response to the the SEC's – rather than in response to the SRO's – decision?

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OPINIONS BELOW

The opinion of the Court of Appeals is reported at 592 F.3d 147 and is reprinted in the appendix to the Petition, at App. 1. The SEC's opinion is reported at 94 SEC Docket 933, and is reprinted in the appendix to this Petition, at App. 43.

JURISDICTION

The Court of Appeals entered its judgment on January 12, 2010. This Court has jurisdiction under 28 U.S.C. § 1254(1).

STATUTES INVOLVED

This case involves the Securities Exchange Act, 15 U.S.C. § 78y(c)(1), which states: "No objection to an order or rule of the Commission, for which review is sought under this section, may be considered by the court unless it was urged before the Commission or there was reasonable ground for failure to do so."

STATEMENT OF THE CASE

This case arises from an SEC decision against Michael F. Siegel that affirmed the sanctions and findings from an NASD disciplinary proceeding, and implicates the integrity of the SEC's review of SRO disciplinary decisions – a review process that, by

definition, "play[s] a critical role in setting standards for the securities industry." SEC Rules of Practice, Exchange Act Rel. No. 34-35833 (June 9, 1995), 1995 WL 368865, *85.[1]

The NASD's Department of Enforcement ("DOE") filed a complaint against Siegel on November 25, 2002, charging him with engaging in private securities transactions and unsuitable recommendations of securities. R. 6. After a three-day hearing, during which evidence was presented that Siegel had no disciplinary record prior or subsequent to the events at issue (R. 2020), the NASD Office of Hearing Officers ("OHO") found Siegel had violated the rules and ordered him to pay a $30,000 fine and to serve two concurrent six-month suspensions. R. 2441.

Siegel appealed the OHO's decision to the National Adjudicatory Council ("NAC") – the appellate body within NASD. The NAC reversed three aspects of the OHO's findings. Of import here, it reversed the OHO's decision to issue concurrent suspensions, purportedly providing "guidance" for the first time regarding consecutive rather than concurrent suspensions, and ordered Siegel to serve the suspensions consecutively. Siegel timely appealed its decision to the SEC.

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[1] NASD has since become FINRA. For ease of reference, Siegel uses the term NASD throughout this brief.

The SEC upheld the NAC's findings and sanctions in their entirety, accepting in particular the NAC's rendition of two consecutive, rather than concurrent, six-month suspensions. Siegel timely petitioned the Court of Appeals for review.

Siegel argued on appeal, in part, that the SEC erred in failing to consider whether Siegel's disciplinary history after the alleged violations militates in favor of concurrent suspensions. The SEC responded that Siegel had waived the argument by not raising it before the SEC Citing 15 U.S.C. § 78y(c)(1), the Court of Appeals agreed and refused to consider the issue.

REASONS FOR GRANTING THE PETITION

The Court of Appeals's decision here would permit the SEC to review any given SRO decision in one of two different ways – a wholly unconstrained review of the SRO record, without regard for the issues raised by the parties, or one limited to the parties' arguments before it. This ambiguity should be addressed now because it widely affects members of the securities industry and the fairness of SRO disciplinary proceedings to which members are subject.

In this case, the Court of Appeals tackled for the first time the factors relevant to the SEC's assessment of consecutive and concurrent disciplinary suspensions as excessive or oppressive under the Securities Exchange Act, 15 U.S.C. § 78s(e)(2). In the

process, the lower court excused the SEC for failing to consider record evidence that courts have deemed material in assessing the remedial efficacy of a suspension in other disciplinary-review cases. It did so because Siegel (supposedly) did not argue about the evidence before the SEC, and the SEC did not consider it.

The lower court's refusal to address the issue misinterprets the scope and purpose of the SEC's review of SRO disciplinary decisions, which differs from that of a typical appellate body. In conducting its review, the SEC must consider all mitigating factors – indeed, all evidence – in rendering a disciplinary sanction. It "scratch-conduct[s] an independent review of facts and law" and "should not, as a matter of policy, ignore material issues or allow errors unaddressed by the parties to stand" "even if the parties have themselves failed to raise those issues." *Schellenbach v. SEC*, 989 F.2d 907, 909 (7th Cir. 1993); SEC Rules of Practice, Exchange Act Rel. No. 34-35833 (June 9, 1995), 1995 WL 368865, *85.

This important regulatory review plays a critical role in the integrity of the securities industry and the fairness of the process to its members. Indeed, the SEC stresses time and again that its independent review of disciplinary records protects industry participants by – curing any errors committed by an SRO tribunal. *See Heath v. SEC*, 586 F.3d 122, 142 (2d Cir. 2009) ("[B]ecause the SEC conducted a thorough, *de novo* review of the record, any procedural errors that may have been committed by the [NYSE's] Chief Hearing Officer are cured."), *cert. denied*, ___ S.Ct.

___, 2010 WL 562803 (2010); *Gregory M. Dearlove*, Exchange Act Rel. No. 57244 (Jan. 31, 2008), 2008 WL 281105, *10 & n.42 (concluding that *de novo* review cured any error by the law judge to support his findings properly), *petition denied*, 573 F.3d 801 (D.C. Cir. 2009). Despite this long-standing policy, the Court of Appeals exempted the SEC from fulfilling its obligations to conduct an unfettered and independent review of the SRO record.

Permitting the court's logic to stand would deny industry members the assurance that the SEC's *de novo* review provides a "safety net" – in many cases, the *only* safety net given the deferential review appellate courts ascribe to agency decisions – against procedural, legal, or factual errors made by SRO tribunals.

I. The SEC Record Contains Evidence That Siegel Has No Disciplinary Record Subsequent to the Events at Issue in the NASD Proceeding.

"It is familiar law that the purpose of . . . suspension from trading is to protect investors, not to penalize brokers." *McCarthy v. SEC*, 406 F.3d 179, 188 (2d Cir. 2005). The Securities Exchange Act authorizes exclusion from the securities business as a remedial measure, not as a penalty. *McCarthy*, 406 F.3d at 188.

As the lower court noted, "[u]ndue focus on past actions may raise doubts about the propriety of a sanction." *Siegel*, 592 F.3d at 158. In *Johnson v. SEC*,

87 F.3d 484, 485 (D.C. Cir. 1996), for example, the court ruled that the SEC's six-month suspension of a supervisor was punitive. It noted that "[t]his sanction would less resemble punishment if the SEC had focused on Johnson's current competence or the degree of risk she posed to the public," but that it had justified the suspension "solely in view of Johnson's past conduct." *Id.* at 489-90. Accordingly, the court concluded that the SEC's "inquiry into Johnson's current competence or the danger she posed to the public (and the SEC cites to no such inquiry) was at most *pro forma*" and inadequate to state a remedial purpose for the suspension. *Id.* at 490.

Likewise, in *McCarthy v. SEC*, 406 F.3d 179, 189 (2d Cir. 2005), the Second Circuit chided the SEC for failing to explain the remedial purpose of a two-year suspension, where petitioner "was a minor participant in the" sanctionable activity, "his violations were of relatively short duration," he had been lawfully trading ever since the violations, and, "with the exception of his [sanctionable conduct], he ha[d] operated lawfully and within the rules." It suggested that, under those circumstances, the suspension would actually "work an excessive and punitive result – namely, the destruction of the brokerage practice [petitioner] has built during several years of rule-abiding trading." *Id.* at 190; *see also Beck v. SEC*, 430 F.2d 673, 674-75 (6th Cir. 1970) (holding that, because petitioner had never violated the securities laws or business ethics during nine years that had passed since his violation, as well as "respondent's

diligence in pursuing this matter over an eight-year period," "the extra margin of deterrence that a four-month suspension would provide, when considered in light of the impact of events since [the violation] must be considered negligible").

The record here shows Siegel had no disciplinary history prior to the events before the NASD, and has had none since. R. 2020. In accordance with *Johnson*, *McCarthy*, and *Beck*, Siegel argued before the Court of Appeals that the SEC erred in failing to consider this fact, which militates in favor of concurrent, rather than consecutive, suspensions. The SEC argued in response that Siegel had waived the argument by not raising it before the SEC The Court of Appeals agreed, citing 15 U.S.C. § 78y(c)(1).

II. The Court of Appeals Erroneously Invoked 15 U.S.C. § 78y(c)(1).

15 U.S.C. § 78y(c)(1) limits appellate review of SEC orders and decisions in some cases: "No objection to an order or rule of the Commission, for which review is sought under this section, may be considered by the court unless it was urged before the Commission or there was reasonable ground for failure to do so." In the context of SEC rulemaking activity – such as proposed rules – 15 U.S.C. § 78y(c)(1) makes sense: Aggrieved parties in those circumstances have notice of the SEC's position and, with full knowledge of what they face, have an opportunity to bring to the SEC's attention all of their objections.

But, applying the provision to the SEC's review of SRO disciplinary decisions stands the process on its head: Before the SEC rules on a petition for review of an SRO disciplinary decision, an aggrieved party has *no* SEC order to object to at all. Indeed, a party obtaining *de novo* review of an SRO decision – during which the SEC "scratch-conduct[s] an independent review of facts and law" – has no way to divine what the SEC will find, or what it will rely upon, or what its order ultimately will say. *Schellenbach*, 989 F.2d at 909. Requiring such clairvoyance by forcing parties aggrieved by an SRO decision to object to a future SEC decision presents an unattainable bar that parties to review proceedings could never reach.

Moreover, this reading of 15 U.S.C. § 78y(c)(1) directly undermines the SEC's role as a "safety net" for members in the securities industry subject to SRO disciplinary actions. The SEC has pronounced that it is not bound to consider *only* the arguments parties in SRO review proceedings present, and for good reason:

> The Commission believes that the *de novo* standard requires consideration of the entire record of a proceeding including material issues on that record, even if the parties have themselves failed to raise those issues. . . . Commission opinions on review play a critical role in setting standards for the securities industry. While it is not inconsistent with a *de novo* standard for the Commission to expect the parties to raise material issues and to bring forward relevant portions of the record, the Commission

> should not, as a matter of policy, ignore material issues or allow errors unaddressed by the parties to stand.
>
> SEC Rules of Practice, Exchange Act Rel. No. 34-35833 (June 9, 1995), 1995 WL 368865, *85.

This case punctuates the inequity in misapplying 15 U.S.C. § 78y(c)(1). The SEC record evidence shows that Siegel had and has no disciplinary record prior or subsequent to the events at issue in the NASD proceeding. R. 2020. Assuming Siegel did not make this *argument* to the SEC (which he disputes), the SEC, in accordance with its own pronouncement, was still bound to consider this *evidence* during its *de novo* review. The Court of Appeals, however, erroneously excused this failure by taxing Siegel with the knowledge that the SEC would ignore record evidence, even though Siegel could not have known the contours of the SEC's decision at the time he presented his arguments to it. Akin to permitting a fact-finder in litigation to rely exclusively on counsel's closing *arguments* in rendering a decision, without regard for the *evidence* admitted in the record, the lower court's application of 15 U.S.C. § 78y(c)(1) is wrong. Given the import of the SEC's review of the entire SRO record, and of its independent determination of the laws and facts presented, this result cannot stand.

CONCLUSION

The court erred in rejecting Siegel's argument about his disciplinary record by relying upon 15 U.S.C. § 78y(c)(1). Its decision opens the door to different levels of review by the SEC – in some cases, the SEC may review an entire record without constraining itself to the parties' briefs; in others, it may simply rely on the arguments presented. Subjecting industry participants – who would have no recourse – to such drastically different forms of review is nothing short of arbitrary. The petition for a writ of certiorari should be granted.

Respectfully submitted,

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United States Court of Appeals
FOR THE DISTRICT OF COLUMBIA CIRCUIT

Argued September 14, 2009 Decided January 12, 2010

No. 08-1379

MICHAEL FREDERICK SIEGEL,
PETITIONER

v.

SECURITIES AND EXCHANGE COMMISSION,
RESPONDENT

On Petition for Review of an Order
of the Securities & Exchange Commission

George C. Freeman, III argued the cause for petitioner. With him on the briefs was *Meredith A. Cunningham*.

Rada Lynn Potts, Senior Litigation Counsel, Securities and Exchange Commission, argued the cause for respondent. With her on the brief were *David M. Becker*, General Counsel, and *Jacob H. Stillman*, Solicitor.

Before: GARLAND, *Circuit Judge*, and EDWARDS and RANDOLPH, *Senior Circuit Judges*.

Opinion for the Court filed by *Senior Circuit Judge* EDWARDS.

EDWARDS, *Senior Circuit Judge*: This case involves a disciplinary action brought by the National Association of Securities Dealers ("NASD")* against Michael Frederick Siegel ("Siegel"). From October 1997 to June 1999, Siegel worked as a registered, general securities representative with Rauscher Pierce Refsnes, Inc. ("Rauscher"), a NASD member firm. In 2002, NASD's Department of Enforcement filed a complaint with NASD's Office of Hearing Officers ("OHO") charging that, during his tenure with Rauscher, Siegel violated NASD Conduct Rules when four of his clients – Linda and Huntington Downer ("the Downers") and Dorothy and Barry Landry ("the Landrys") – invested in World Environmental Technologies, Inc. ("World ET"), a speculative, start-up company in search of financing. World ET eventually failed and the Downers and Landrys lost their investments. In its complaint, the Department of Enforcement alleged that Siegel violated NASD Conduct Rules 3040 and 2110 when he "sold away," *i.e.*, engaged in private securities transactions on

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* NASD was a national association of securities broker-dealers registered with the Securities and Exchange Commission ("SEC") under § 15A of the Exchange Act, 15 U.S.C. § 78o-3. In 2007, NASD changed its name to Financial Industry Regulatory Authority, Inc. ("FINRA"). *See* Securities Exchange Act Release No. 56,146 (July 26, 2007), 2007 SEC LEXIS 1641, at *9; *see also In re Michael Frederick Siegel*, Exchange Act Release No. 58,737 (Oct. 6, 2008), 2008 SEC LEXIS 2459, at *2 n.1, *reprinted in* 2 Joint Appendix ("J.A.") 678 n.1. Because the disciplinary action against Siegel was initiated in 2002, this opinion refers to "NASD," not "FINRA."

behalf of his clients without providing prior written notice to Rauscher, and NASD Conduct Rules 2310 and 2110 when he recommended World ET to his clients without having any reasonable grounds for believing that his recommendations were suitable.

After a hearing, an OHO panel found that Siegel had engaged in the violations alleged. The panel imposed a six-month suspension and a $20,000 fine for the Rules 3040/2110 violations, and a six-month suspension and a $10,000 fine for the Rules 2310/2110 violations. The panel declined to impose restitution and the suspensions were to be served concurrently. *See Dep't of Enforcement v. Michael Frederick Siegel,* No. C05020055 (Apr. 19, 2004) ("*Initial OHO Decision*"), *reprinted in* 2 J.A. 463-79. The matter was appealed to NASD's National Adjudicatory Council ("NAC"). Following a remand to the OHO panel, *see In re Michael Frederick Siegel,* No. C05020055 (July 26, 2005) ("*Initial NAC Decision*"), *reprinted in* 2 J.A. 482-87, NAC affirmed the panel's initial findings, with two modifications. NAC ordered Siegel to serve his suspensions consecutively and ordered Siegel to pay restitution in the amounts of $300,300 to the Downers and $100,000 to the Landrys. *See In re Michael Frederick Siegel,* No. C05020055 (May 11, 2007) ("*Second NAC Decision*"), *reprinted in* 2 J.A. 497-521; *In re Michael Frederick Siegel,* No. C05020055 (Dec. 4, 2007) ("*NAC Supplemental Decision*"), *reprinted in* 2 J.A. 642-58. Siegel appealed to the SEC, which affirmed NAC's decision on all counts. *In re Michael Frederick Siegel,* Exchange Act Release No.

58,737 (Oct. 6, 2008) ("*SEC Decision*"), 2008 SEC LEXIS 2459, at *1-*58, *reprinted in* 2 J.A. 677-701.

In his petition for review to this court, Siegel's principal argument is that, because the SEC failed to properly assess the "cause" of the losses suffered by the Landrys and Downers, the agency's decision to uphold NASD's awards of restitution was an abuse of discretion. We agree. NASD General Principle No. 5, which the SEC purported to apply in this case, describes restitution as a "traditional remedy used to restore the status quo ante where a victim otherwise would unjustly suffer loss"; and it states that restitution may be ordered when a party "has suffered a quantifiable loss as a result of a respondent's misconduct." General Principle No. 5, FINRA Sanction Guidelines at 4 ("Principle 5"). The SEC completely failed to articulate any meaningful standards governing the level of causation required under Principle 5.

This case involves wealthy and sophisticated customers who were under no press of time to decide whether to invest; customers who invested specifically in furtherance of a desire to speculate; and a broker who did not profit from his wrongdoing and who has been fined and suspended for his violations. There is nothing in the SEC's decision to indicate why, in these circumstances, awards of restitution are appropriate under Principle 5. Indeed, the SEC's decision is incomprehensible insofar as it attempts to amplify any meaningful causal connection between Siegel's putative bad acts and the Downers' and Landrys' losses. And the SEC has cited no precedent,

and we have found none, supporting restitution in a case of this sort. The SEC's judgment is fatally flawed for two reasons: First, the SEC's judgment is not supported by reasoned decisionmaking. Second, the SEC cites to no controlling precedent that includes reasoned decisionmaking supporting restitution under Principle 5 in a case of this sort. We therefore vacate the restitution order.

We reject Siegel's remaining challenges. Substantial evidence supports the SEC's findings that Siegel violated NASD's rules barring selling away and unsuitable recommendations. And the SEC did not abuse its discretion in imposing fines and consecutive six-month suspensions for Siegel's separate violations of Rules 3040/2110 and Rules 2310/2110.

I. BACKGROUND

A. *Siegel's Involvement in World ET*

Siegel has worked as a registered general securities representative since 1981. From October 24, 1997 to June 16, 1999, he was associated with Rauscher, a NASD member firm. In early 1997, before Siegel joined Rauscher, he had several conversations with representatives of World ET, where he learned of the company's burgeoning efforts to offer antibacterial services to the poultry and swine industries. World ET representatives advised Siegel that the company was seeking to acquire the formula for a product called "Nok-Out" that could kill 99% of bacteria, fungi, and viruses on contact. In December 1997,

World ET purchased the formula via a promissory note.

Siegel subsequently agreed to join World ET's board, to serve as a consultant to the company, and to help it raise the capital necessary to go public. On November 24, 1997, Siegel submitted a written request to Rauscher's compliance department for approval to sit on World ET's board. The department approved Siegel's request, but noted that Siegel would "not be able to effect transactions in securities of [World ET]" if the company went public. Inter-Office Memorandum from Jill Ivancevich, Compliance Department, Rauscher Pierce Refsnes, Inc., to Michael Siegel (Nov. 24, 1997), *reprinted in* 1 J.A. 283.

B. *Siegel's Involvement with the Downers and the Landrys*

Siegel began managing investments for Huntington and Linda Downer in 1993. Huntington Downer was a prominent state legislator and former law firm partner, with experience in state budget and finance matters. Huntington Downer also had previously invested in speculative oil and gas ventures. The combined net worth of the Downers was between $1.5 million and $2 million. When Siegel joined Rauscher, the Downers transferred their holdings to a Rauscher account. Over time, the couple afforded Siegel significant discretion over their funds, providing him "complete authority" to do "what he wanted." Tr. of Hearing (Oct. 8-10, 2003), *reprinted in* 1 J.A. 49-50.

The Downers acknowledged that they were "happy" with Siegel's representation. *Id.* at 50.

Siegel visited the Downers at their home in early 1997. The purpose of the meeting, according to Siegel, was to "bring them up to date" on the state of their investments. *Id.* at 188. The parties discussed personal matters, including Huntington Downer's interest in running for governor and Siegel's new radio show on investing. They also discussed World ET, Siegel's application to serve on the company's board, and the Nok-Out product. Siegel gave the Downers a Nok-Out sample to use on their cat's litter box. At some point during this meeting, Huntington Downer expressed an interest in investing with World ET. Siegel advised the Downers that they could not invest until the company went public, but Huntington Downer pressed Siegel to contact the company and inquire about investment opportunities. Siegel subsequently spoke with World ET representatives, who informed him that the Downers could invest $300,000 in World IEQ Technologies, Inc. ("World IEQ"), a purported subsidiary of World ET. Siegel relayed this information to the Downers, who asked Siegel to obtain the documentation necessary for them to invest.

On November 24, 1997, Siegel visited the Downers again, this time bringing documents related to the proposed World IEQ investment. The paperwork included a "Subscription Agreement" and a "Subscriber Prospective Offeree Questionnaire." Siegel did not review these documents prior to delivering

them. As he later testified, had he done so, he would have seen that the offering documents were deficient. Both documents referenced an investment in a debenture, which is an unsecured bond. Neither document, however, included any information on interest rates or repayment terms. Moreover, the two documents were inconsistent in the limited investment information they provided. Huntington Downer promptly signed and returned the documents, but Siegel still declined to review the paperwork. He did, however, fax the documents to World ET. Later, on December 1, 1997, Siegel transferred $300,300 from the Downers' Rauscher account to a World IEQ bank account after receiving written authorization from the Downers to do so.

Within two weeks, World ET contacted Siegel to notify him that the World IEQ investment was no longer viable and that the Downers could receive a refund of their initial investment or transfer it to World ET. When Siegel relayed this information to his clients, Huntington Downer sought Siegel's advice on how to proceed. In response to this inquiry, Siegel told Downer: "I would rather be in the mother company if I had a choice." *Id.* at 251. The Downers subsequently opted to invest in World ET. They never received or signed any new documentation concerning the investment.

* * *

In November 1997, Dorothy and Barry Landry opened an account with Siegel at Rauscher. The

Landrys had recently sold Ms. Landry's business and were looking to invest. They provided Siegel with $1 million in funds and afforded him significant independent investment discretion. In late 1997, Siegel met with the Landrys to complete the paperwork necessary to open their Rauscher account. At that meeting, Siegel raised the possibility of investing in World ET as "something [the Landrys] might be interested in" and that they should "take a look at." *Id.* at 123. The Landrys expressed interest, which Siegel relayed to World ET. Officials at World ET then sent along documentation for the Landrys to sign. Siegel delivered the offering documents to the Landrys, but he did not review them. As with the Downers, the documentation was deficient. The papers included a subscription agreement that described the purchase of one debenture "unit" at $100,000, but contained no maturity date for the debenture and no interest rate. World Environmental Technologies, Inc., Subscription Agreement, *reprinted in* 1 J.A. 313-15.

On Siegel's advice, the Landrys held onto the documents to review them over the next few months before making a final investment decision. On February 5, 1998, the Landrys directed Siegel to transfer $100,000 from their Rauscher account to their joint bank account. Six days later, the Landrys gave the signed documents and a $100,000 check to Siegel, who sent both to World ET. World ET negotiated the check, but the Landrys never received any documentation confirming their investment.

World ET was never approved to be publicly traded. The company made its last payment on the Nok-Out promissory note in October 1998. On August 28, 2002, World ET lost its rights to Nok-Out. On February 13, 2004, the Texas Secretary of State revoked World ET's corporate charter.

Siegel's direct involvement with World ET included signing a resolution authorizing its acquisition of Nok-Out; loaning the company $22,000 on January 14, 1998; entering into an employment agreement on January 27, 1998 to raise a minimum of $15 million for World ET in exchange for cash and company shares; and making an additional loan to the company of $20,166.01 on March 6, 1998. Neither Siegel, the Downers, nor the Landrys ever received any payment from World ET.

C. *Disciplinary Proceedings Against Siegel*

Broker-dealers who trade in securities are subject to the regulations covering national securities associations. During the events relevant to this case, NASD was a registered national securities association and acted pursuant to quasi-governmental authority to oversee the activities of its members and associated persons. As we explained in *National Ass'n of Securities Dealers, Inc. v. SEC*, 431 F.3d 803 (D.C. Cir. 2005):

> Two provisions of the Exchange Act define NASD's quasi-governmental authority to adjudicate actions against members who are

accused of unethical or illegal securities practices and the Commission's oversight of that authority. These are §§ 15A and 19. Section 15A, 15 U.S.C. § 78o-3, lays out the specific duties of a registered national securities association. It sets out disciplinary functions which NASD, as a registered national securities association, must perform. . . . 15 U.S.C. § 78o-3(b)(6). Where NASD members have allegedly violated either association rules or federal securities law, NASD has the authority to consider disciplinary action in the first instance. *See* 15 U.S.C. § 78o-3(b)(7). If NASD proceeds against a member, it must provide a minimum level of process, including notice of the specific charges and an opportunity to be heard, as well as a statement of subsequent findings. *See* 15 U.S.C. § 78o-3(h). Fair disciplinary procedures are a prerequisite for registration of a national securities association. 15 U.S.C. § 78o-3(b)(8).

Given the statutory requirements of § 15A, NASD . . . established an elaborate adjudicative arm to address disciplinary actions. . . . Where a complaint has been filed against members for violations of federal securities laws, the adjudication may take place before a NASD Hearing Panel [in NASD's Office of Hearing Officers]. . . . As noted above, Hearing Panel [*i.e.*, OHO panel] decisions may be appealed to NAC, or they may be reviewed by NAC on its own initiative. . . .

> Section 19, 15 U.S.C. § 78s, sets out the Commission's supervisory duties over all "self-regulatory organizations." NASD is a "self-regulatory organization" by virtue of the fact that it is a "registered securities association" under § 15A. *See* 15 U.S.C. § 78c(a)(26) (definition of "self-regulatory organization"). With respect to adjudications, the Commission's oversight begins with the obligation of self-regulatory organizations to notify the Commission of any final disciplinary sanction imposed on a member or associated person. 15 U.S.C. § 78s(d)(1). The statute also provides the Commission with plenary review powers. 15 U.S.C. § 78s(e). Once notified, the Commission may, on its own motion or on the application of any person aggrieved by the association's action, review NASD's disciplinary action. 15 U.S.C. § 78s(d)(2). . . . Section 19(e) authorizes the Commission to make an independent determination as to whether the violations found by the association occurred, and to change NASD's sanctions in whatever ways it deems appropriate. *See* 15 U.S.C. § 78s(e). The Commission may base its determination on the record compiled by the association, but it is not limited to that record and may adduce additional evidence.

Id. at 805-06.

On November 26, 2002, NASD's Department of Enforcement filed a complaint with NASD's OHO. The complaint alleged that Siegel violated NASD

Conduct Rules 3040 and 2110 when he "sold away," *i.e.*, engaged in private securities transactions on behalf of his clients without providing prior written notice to Rauscher, and NASD Conduct Rules 2310 and 2110 when he recommended World ET to his clients without having any reasonable grounds for believing that his recommendations were suitable. Complaint ¶¶ 1-31, *In re Michael Frederick Siegel,* No. C05020055 (Nov. 25, 2002), *reprinted in* 1 J.A. 20-27.

Rule 3040 states:

> Prior to participating in any private securities transaction, an associated person shall provide written notice to the member with which he is associated describing in detail the proposed transaction and the person's proposed role therein and stating whether he has received or may receive selling compensation in connection with the transaction. . . .

NASD Conduct Rule 3040, NASD Manual 3040(b). A "[p]rivate securities transaction" is defined as "any securities transaction outside the regular course or scope of an associated person's employment with a member." *Id.* 3040(e)(1).

Rule 2310 states:

> In recommending to a customer the purchase, sale or exchange of any security, a member shall have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to

> his other security holdings and as to his financial situation and needs.

NASD Conduct Rule 2310, NASD Manual 2310(a). As noted above, Siegel acknowledged that he did not review the offering documents before conveying the materials to the Downers and the Landrys.

Rule 2110 states:

> A member, in the conduct of his business, shall observe high standards of commercial honor and just and equitable principles of trade.

NASD Conduct Rule 2110, NASD Manual 2110. "It is well settled that a violation of a . . . NASD rule or regulation also constitutes a violation of Conduct Rule 2110." *SEC Decision,* 2008 SEC LEXIS 2459, at *20 n.13, 2 J.A. 685 (citing *In re Stephen J. Gluckman,* Exchange Act Release No. 41,628 (July 20, 1999), 1999 SEC LEXIS 1395, at *22-*23).

After an initial hearing, the OHO panel found that Siegel violated Rule 2310, Rule 3040, and Rule 2110. *Initial OHO Decision,* 2 J.A. 463-79. The panel imposed sanctions, including a $20,000 fine with a six-month suspension for "selling away" (Rules 3040 and 2110), and a $10,000 fine with a separate six-month suspension for making unsuitable recommendations to the Downers and Landrys (Rules 2310 and 2110). *Id.* at J.A. 479. The panel allowed Siegel to serve his two suspensions concurrently and did not order him to pay restitution to the customers. Justifying the latter decision, the panel noted that the

Downers and the Landrys were "relatively sophisticated persons, who voluntarily chose to invest in a risky enterprise"; that "Siegel earned nothing from the transactions and lost his own money"; and that the customers were separately pursuing arbitration to recoup their losses. *Id.* at 478.

Siegel appealed to NAC. After initially remanding the case to the OHO panel to make certain credibility determinations and factual findings, *see Initial NAC Decision,* 2 J.A. 482-87, NAC affirmed the panel's initial findings with two modifications. *See Second NAC Decision,* 2 J.A. 497-521. First, NAC ordered Siegel to serve his suspensions consecutively rather than concurrently. *Id.* at 516-17. Second, NAC ordered Siegel to pay restitution in the amounts of $300,300 to the Downers and $100,000 to the Landrys, *less* any value the customers received from selling their securities, any residual value in the securities that the customers had not sold, and any restitution that the customers had recovered through other avenues. *Id.* at 519-20. The case was then referred to a NAC subcommittee to determine whether the restitution amounts should be reduced. *See id.* After receiving a recommendation from the subcommittee, NAC concluded that no offsets were required and ordered Siegel to pay 100% restitution to the victims – $300,300 to the Downers and $100,000 to the Landrys. *See NAC Supplemental Decision,* 2 J.A. 642-58.

Siegel appealed to the SEC, which affirmed NAC's liability and sanction determinations. *SEC*

Decision, 2008 SEC LEXIS 2459, at *1-*58. On the Rule 2310 violation, the SEC grounded its analysis on the view that "'a broker may violate the suitability rule if he fails so fundamentally to comprehend the consequences of his own recommendation that such recommendation is unsuitable for any investor, regardless of'" individual characteristics. *Id.* at *28, 2 J.A. 689 (quoting *In re F.J. Kaufman & Co.,* Exchange Act Release No. 27,535 (Dec. 13, 1989), 1989 SEC LEXIS 2376, at *11). As noted above, Siegel acknowledged that he did not review the offering documents that he conveyed to the Downers and the Landrys. The Commission focused on the flaws in those documents and on Siegel's concession that the deficiencies in the documents rendered an investment in World IEQ and World ET unsuitable for any investor. *Id.* at *31, 2 J.A. 690. The Commission rested on these grounds, explicitly declining to address "whether World ET was suitable for the Downers and the Landrys based upon their personal situations." *Id.* at *31 n. 26, 2 J.A. 690.

On appeal to this court, Siegel contests his liability for having made a "recommendation" to the Downers, as well as each of the sanctions imposed by the SEC.

II. Analysis

A. *Standard of Review*

The question of whether Siegel "recommended" an investment to the Downers under Rule 2310 is a

"facts and circumstances" inquiry. *SEC Decision,* 2008 SEC LEXIS 2459, at *21, 2 J.A. 686 (internal quotation marks and citation omitted). The SEC's findings of fact are reviewed under the "very deferential" substantial evidence standard, *see Dolphin & Bradbury, Inc. v. SEC,* 512 F.3d 634, 639 (D.C. Cir. 2008) (internal quotation marks and citation omitted), and are conclusive if "a reasonable mind might accept [the] evidentiary record as adequate" to support the agency's conclusions. *Id.* (internal quotation marks and citation omitted); *see also* 15 U.S.C. § 78y(a)(4). Under this standard, the reviewing court must consider all relevant evidence; however, the court "'may not find substantial evidence merely on the basis of evidence which in and of itself justified [the agency's decision], without taking into account contradictory evidence or evidence from which conflicting inferences could be drawn.'" *Morall v. DEA,* 412 F.3d 165, 177 (D.C. Cir. 2005) (quoting *Lakeland Bus Lines, Inc. v. NLRB,* 347 F.3d 955, 962 (D.C. Cir. 2003) (internal quotation marks and citation omitted)). The reviewing court may not substitute its own judgment for the agency's "choice between two fairly conflicting views," even if that court "would justifiably have made a different choice had the matter been before it *de novo.*" *See Universal Camera Corp. v. NLRB,* 340 U.S. 474, 488 (1951).

The SEC reviews sanctions imposed by the NASD to determine whether they "impose[ ] any burden on competition not necessary or appropriate" or are "excessive or oppressive." 15 U.S.C. § 78s(e)(2);

see also PAZ Sec., Inc. v. SEC, 494 F.3d 1059, 1065-66 (D.C. Cir. 2007) ("*PAZ I*"). This court reviews the SEC's conclusions regarding sanctions to determine whether those conclusions are arbitrary, capricious, or an abuse of discretion. *See PAZ Sec., Inc. v. SEC*, 566 F.3d 1172, 1174 (D.C. Cir. 2009) ("*PAZ II*"). "The agency's choice of remedy is 'peculiarly a matter for administrative competence,' and we will reverse it 'only if the remedy chosen is unwarranted in law or is without justification in fact.'" *Id.* (quoting *Am. Power & Light Co. v. SEC*, 329 U.S. 90, 112-13 (1946)).

B. *Siegel's Liability for Violating Rule 2310 with Respect to the Downers*

In conducting its inquiry into whether Siegel recommended World ET investments to the Downers within the meaning of Conduct Rule 2310, the SEC properly considered the "'content, context, and presentation'" of Siegel's communications, and whether, as an objective matter, Siegel's communication "'reasonably could have been viewed as a call to action' and 'reasonably would influence an investor to trade a particular security or group of securities.'" *SEC Decision*, 2008 SEC LEXIS 2459, at *21, 2 J.A. 686 (quoting NASD Notice to Members, 01-23 (Apr. 2001), 2001 NASD LEXIS 28, at *8-*9, *19). In concluding that Siegel "recommended" World ET to the Downers, the SEC focused on a number of "main factors." *Id.* at *22, 2 J.A. 686. These factors included the close relationship between the Downers and Siegel, the Downers' reliance on Siegel for investment advice, the

nature of the specific conversations between the Downers and Siegel regarding investments in World ET, and Siegel's initiation of conversations concerning World ET with the Downers. *Id.* at *21-*22, 2 J.A. 686-87. On the basis of this evidence, the SEC concluded that Siegel's "conduct constitute[d] a recommendation because it was a 'call to action' that reasonably influenced the Downers . . . to invest in World ET." *Id.* at *24, 2 J.A. 687.

We have lit+le doubt that the SEC's conclusion is supported by substantial evidence. Siegel contends that he specifically discouraged the Downers from investing and only acted as an intermediary with World ET at Huntington Downer's insistence. Pet. Br. at 49-50. The SEC noted, however, that "Siegel admit[ted] that he could have refused" this request. *SEC Decision,* 2008 SEC LEXIS 2459, at *23, 2 J.A. 686. Siegel also contends that he declined to review the offering documents that he gave to the Downers in an attempt to avoid violating Rule 3040's prohibition against engaging in a private securities transaction without providing written notice to Rauscher, and Rule 2310's prohibition against unsuitable recommendations, and communicated as much to the Downers. *See* Pet. Br. at 51-52. But this explanation does not speak to the question of whether Siegel's communications with the Downers could be perceived by a reasonable person in the Downers' position as a "suggestion to invest" in World ET and, thus, raise the specter of a violation of Rule 2310.

More importantly, as the SEC found, following his initial conversations with the Downers, Siegel "encourag[ed the Downers] to invest in World ET after learning they could not invest" in the subsidiary company, World IEQ. *SEC Decision,* 2008 SEC LEXIS 2459, at *25, 2 J.A. 687. As the agency notes, "[a]fter Siegel informed the Downers that it was no longer possible to invest in World IEQ, he advised them to invest in World ET rather than receive a refund on their World IEQ investment, stating that he 'would rather be in the mother company if [he] had a choice.'" *Id.* at *23, 2 J.A. 686. Siegel provides no explanation for how this statement can be interpreted as anything other than a suggestion to invest in World ET. This interaction alone is sufficient to sustain the SEC's finding that Siegel recommended an investment.

C. *Mitigating Factors*

Siegel contends that the SEC failed to appropriately consider certain mitigating factors prior to imposing sanctions. His arguments are unpersuasive and warrant little attention here. The Government's brief on behalf of the SEC more than ably addresses this issue:

> Siegel argues that NASD's sanctions are "inappropriate" in light of allegedly mitigating factors "the SEC largely brushed aside." . . . [T]he Commission properly found that a number of Siegel's claims of mitigation were not supported in the record. The remaining

claims fall into two categories: (1) those that could not be mitigating – even if they were present in the record; and (2) those that, although mitigating and present in the record, are outweighed by aggravating factors. . . .

In the first category of claims are those that the Commission refused to credit because doing so would turn ignorance of regulatory requirements into excuses for misconduct or reward [for] simply complying with such requirements. Thus, for example, the Commission refused to excuse Siegel's Rule 3040 violations based on his purported "misunderstanding" of the rule. As the Commission held, that claim is "especially not mitigating because of [Siegel's] seventeen years of experience as an associated person . . . and the fact that he has been active as a registered investment advisor, authored a book on investment advice, and served as a local media expert on financial topics."

In addition, the Commission refused to consider mitigating Siegel's assertions that he: had no disciplinary history; cooperated in NASD's investigation; never performed any act pursuant to the World ET employment agreement; did not attempt to create the impression that Rauscher sanctioned his activities; and did not recruit other registered individuals to sell World ET securities. Siegel also asserts as mitigating that World ET securities have not been found to involve a violation of the securities laws or rules. While these are factors listed in the

> guidelines as either general considerations applicable to all sanction determinations . . . or violation-specific considerations . . . not every consideration listed in the guidelines has the potential to be mitigating. . . .
>
> Thus, as the Commission explained, the presence of any of the factors listed above could justify an increase in sanctions, but their absence is not mitigating "because an associated person should not be rewarded for acting in compliance with the securities laws and with his duties as a securities professional." . . .
>
> Finally, Siegel does point to a number of factors that the Commission concluded had some mitigating impact: that his acts of misconduct were neither numerous nor made over an extended period of time; that a small number of customers were involved; that those customers were sophisticated; and that he disclosed that he was seeking an appointment to World ET's board. The Commission concluded, however, that the mitigating impact of these factors was outweighed by aggravating factors, particularly Siegel's reckless failure to take any steps to inform himself about the securities he recommended to his clients.

Gov't Br. at 35-37 (internal citations omitted).

The Government's discussion of this issue needs no amplification. It is sufficient to say that, on the record here, the SEC reasonably addressed mitigating

and aggravating circumstances in considering sanctions. We reject Siegel's arguments to the contrary.

D. *Concurrent Versus Consecutive Suspensions*

This case represents the first time that the SEC has "addressed whether the imposition of consecutive – as opposed to concurrent – suspensions is excessive or oppressive." *SEC Decision,* 2008 SEC LEXIS 2459, at *46, 2 J.A. 696. As an initial matter, it is important to remember that the agency "may impose sanctions for a remedial purpose, but not for punishment." *McCurdy v. SEC,* 396 F.3d 1258, 1264 (D.C. Cir. 2005). Thus, the SEC must "review the sanction imposed by the NASD with 'due regard for the public interest and the protection of investors,'" *PAZ I,* 494 F.3d at 1065 (quoting 15 U.S.C. § 78s(e)(2)), and ensure that it "serve[s] a remedial purpose, as required by" the Exchange Act. *Id.* at 1061; *see also* 15 U.S.C. § 78s(e)(2). To justify a sanction as remedial, the agency "'must do more than say, in effect, petitioners are bad and must be punished.'" *PAZ I,* 494 F.3d at 1064 (quoting *Blinder, Robinson & Co. v. SEC,* 837 F.2d 1099, 1113 (D.C. Cir. 1988)). The agency must, "at the least[,] . . . give '[s]ome explanation addressing the nature of the violation and the mitigating factors presented in the record.'" *Id.* at 1064-65 (quoting *McCarthy v. SEC,* 406 F.3d 179, 189-90 (2d Cir. 2005)). However, beyond "mak[ing] the necessary 'findings regarding the protective interests to be served' by expulsion," the agency need not "state why a lesser sanction would be

insufficient." *PAZ II,* 566 F.3d at 1175-76 (quoting *McCarthy,* 406 F.3d at 189).

As the SEC noted, NASD's NAC concluded that "because . . . selling away and suitability violations involve different kinds of misconduct and raise separate and serious regulatory concerns," consecutive suspensions would "specifically discourage all types of additional misconduct at issue." *See SEC Decision,* 2008 SEC LEXIS 2459, at *44-*45, 2 J.A. 695-96 (internal quotation marks and citation omitted). The SEC "agree[d] with NASD that Siegel's violations are different in nature and raise separate public interest concerns." *Id.* at *46, 2 J.A. 696. Thus, the SEC imposed consecutive suspensions not to punish Siegel, but rather to protect the public from two fundamentally different types of harms.

As the agency noted, "[t]he purpose of NASD Conduct Rule 3040 is to protect 'investors from unsupervised sales and securities firms from exposure to loss and litigation from transactions by associated persons outside the scope of their employment.'" *Id.* (quoting *In re Chris Dinh Hartley,* Exchange Act Release No. 50,031 (July 16, 2004), 2004 SEC LEXIS 1507, at *13 n.17). The SEC thus found that Siegel's suspension for the Rule 3040 violation "will protect the public interest by discouraging Siegel and others from selling away and from undermining the protections in place at firms." *Id.* The purpose of NASD Rule 2310, on the other hand, is "to protect customers from potentially abusive sales practices by ensuring that a registered representative has reasonable

grounds for believing that his recommendation is suitable." *Id.* The SEC accordingly found that the separate suspension for the Rule 2310 violations "will protect the public interest by encouraging Siegel and others to take the steps necessary to determine that recommendations that they make to their customers are suitable while also deterring them from putting their own interests ahead of those of their customers." *Id.* at *46-*47, 2 J.A. 696-97. Given the deference due to the SEC, we cannot say that the agency abused its discretion in finding that consecutive, six-month suspensions were not excessive or oppressive.

Siegel contends that the SEC erred in focusing on his prior bad acts instead of on the current threat he poses to the investing public. Some cases have suggested that undue focus on past actions may raise doubts about the propriety of a sanction. *See, e.g., Johnson v. SEC,* 87 F.3d 484, 490 (D.C. Cir. 1996). There is no rigid rule on this, however, because "[i]t is difficult to imagine how *any* suspension, remedial or not, could be based on anything but past actions." *McCurdy,* 396 F.3d at 1264.

Siegel also argues that, in imposing consecutive suspensions, the agency improperly relied on general deterrence, which is "essentially a rationale for punishment, not for remediation." *PAZ I,* 494 F.3d at 1066. We do not agree that the SEC erred in this way. This is not a case in which the SEC offered "no other rationale whatsoever" beyond general deterrence. *Id.* Furthermore, "'general deterrence . . . may be

considered as part of the overall remedial inquiry.'" *Id.* (quoting *McCarthy,* 406 F.3d at 189); *see also McCarthy,* 406 F.3d at 189 ("[T]he SEC has expressly adopted deterrence, both specific and general, as a component in analyzing the remedial efficacy of sanctions.").

Finally, Siegel contends that his lack of a disciplinary record subsequent to the events of this case undermines the remedial efficacy of the suspensions. This argument was not raised before the agency, so we decline to consider it here. *See* 15 U.S.C. § 78y(c)(1).

In sum, we hold that the SEC did not abuse its discretion in upholding the consecutive suspensions imposed by NAC.

E. *Restitution*

As noted above, Siegel's principal argument to this court is that, because the SEC failed to properly assess the "cause" of the losses suffered by the Landrys and Downers, the agency's decision to uphold NASD's awards of restitution was an abuse of discretion. There is merit to this claim.

In ordering Siegel to pay restitution in excess of $400,000, in addition to paying fines and serving consecutive suspensions, both the NASD's NAC and the SEC relied on Principle 5 in NASD's Sanction Guidelines. *See Second NAC Decision,* 2 J.A. 518-19;

SEC Decision, 2008 SEC LEXIS 2459, at *48-*52, 2 J.A. 697-99. Principle 5 states, in relevant part:

> Where appropriate to remediate misconduct, Adjudicators should order restitution and/or rescission. Restitution is a traditional remedy used to restore the status quo ante where a victim otherwise would unjustly suffer loss. Adjudicators may determine that restitution is an appropriate sanction where necessary to remediate misconduct. *Adjudicators may order restitution when an identifiable person, member firm[,] or other party has suffered a quantifiable loss as a result of a respondent's misconduct, particularly where a respondent has benefited from the misconduct.*
>
> Adjudicators should calculate orders of restitution based on the actual amount of the loss sustained by a person . . . as demonstrated by the evidence. Orders of restitution may exceed the amount of the respondent's ill-gotten gain. Restitution orders must include a description of the Adjudicator's method of calculation.

Principle 5, at 4 (emphasis added).

Counsel for both parties before this court agreed that, under Principle 5, the SEC must demonstrate a causal connection between a broker's misconduct and any loss at issue. In other words, Siegel cannot be made to pay restitution to the Downers or the Landrys unless the SEC shows that Siegel's misdeeds caused their investment losses. What is unclear,

however, is the level of causation that is required before the agency may impose restitution.

There are several ways in which to construe the causation requirement of Principle 5. One possibility would be to find that Principle 5 requires nothing more than loose, "but for" causation. Under this standard, the agency would be required to determine whether a loss would not have occurred but for the broker's misconduct. As we noted in *Kilburn v. Socialist People's Libyan Arab Jamahiriya,* 376 F.3d 1123 (D.C. Cir. 2004), "but for" causation is an unwieldy concept:

> "But for" causation may be restrictive in some circumstances. . . . *See* PROSSER & KEETON ON THE LAW OF TORTS 66-67 (5th ed. 1984). Often, however, it is viewed as an expansive theory. *See, e.g., Pryor v. American President Lines,* 520 F.2d 974, 978 n.4 (4th Cir. 1975) (describing "but for" causation as a potentially "limitless" standard under which "Eve's trespass caused all our woe" (citing 2 HARPER & JAMES, THE LAW OF TORTS 1108 (1956))); *see generally* PROSSER & KEETON, at 266 (noting that the breadth of "but for" causation may depend on whether it is employed as a rule of inclusion or exclusion).

Id. at 1127 n.2. Recognizing that "but for" causation may indeed be "limitless" in assessing whether restitution is due for broker-dealer violations, the SEC's counsel conceded at oral argument that Principle 5

requires more than a showing of "but for" causation in order to justify restitution.

Another possibility is "proximate causation," which is normally understood to require a *direct relation* between conduct alleged and injury asserted. *See, e.g., Holmes v. Sec. Investor Prot. Corp.*, 503 U.S. 258, 268-69 (1992). It is noteworthy that, in its decision ordering Siegel to pay restitution, NAC appears to assume the applicability of "proximate cause" as the test required by Principle 5. *See Second NAC Decision*, 2 J.A. 519 (inquiring whether "Siegel's violative conduct ever ceased to be the proximate cause of the customers' losses").

Yet another possibility is a "substantial factor" test of causation. This test is sometimes applied when a contested loss has "been brought about by two or more concurrent causes." *Daniels v. Hadley Mem'l Hosp.*, 566 F.2d 749, 757 (D.C. Cir. 1977). Under such a test, the agency would be required to show that a broker's violation of NASD rules was a "'substantial factor' in bringing about the harm" to his clients. *Id.*

Last but not least is "loss causation," best exemplified by the court's decision in *Bastian v. Petren Resources Corp.*, 892 F.2d 680 (7th Cir. 1990). In *Bastian*, the plaintiffs invested $600,000 in oil and gas limited partnerships promoted by the defendants. The plaintiffs, who were fully intent on investing in oil and gas companies, alleged that without the defendants' misrepresentations and misleading omissions, they would not have made these particular

investments, which were "worthless" by 1984 because the entire oil and gas market collapsed in the early 1980s. *Id.* at 682, 684-85. The court noted:

> The plaintiffs alleged that they invested in the defendants' limited partnerships because of the defendants' misrepresentations, and that their investment was wiped out. But they suggest no reason *why* the investment was wiped out. They have alleged the cause of their entering into the transaction in which they lost money but not the cause of the transaction's turning out to be a losing one. . . .
>
> . . . .
>
> If the plaintiffs would have lost their investment regardless of the fraud, any award of damages to them would be a windfall. . . .

Id. at 684-85. The court in *Bastian* held that plaintiffs had not sufficiently pled loss causation because they "were not told that oil and gas partnerships are risk-free. They knew they were assuming a risk that oil prices might drop unexpectedly. . . . [and were] unwilling to try to prove that anything beyond the materializing of that risk caused their loss." *Id.* at 686.

Siegel argued to the SEC and to this court that "loss causation" is the level of causation that is required before the agency may impose restitution pursuant to Principle 5. Siegel points out that the Downers and the Landrys purposefully intended to

pursue speculative investments in World ET. According to Siegel, the customers lost their investments because of World ET's failure, not because of Siegel's failure to review the deficient offering documents. In response to Siegel's insistence that principles of "loss causation" should be followed in this case, the SEC rejected the reasoning of *Bastian* as inapposite, because that case involved "a private action for damages under the antifraud provisions of the federal securities laws where 'loss causation' was an element of the claim." *SEC Decision,* 2008 SEC LEXIS 2459, at *49, 2 J.A. 697.

We do not mean to suggest that the foregoing tests of causation are always clear or mutually exclusive. They are not. Nor do we mean to suggest that we have exhausted all possible tests of causation in pondering the meaning of Principle 5. And we certainly do not mean to suggest that we know which test of causation offers that best construction of Principle 5. We do not. What we do mean to show, however, is that – apart from strict liability and limitless notions of "but for" causation – there are a number of ways in which Principle 5 might be construed. This responsibility belongs to the SEC, not this court. Unfortunately, the SEC has offered virtually nothing to explain the applicable test of causation under Principle 5.

As noted above, Principle 5 sets forth a causation requirement in the following terms: "Adjudicators may order restitution when *an identifiable person, member firm[,] or other party has suffered a quantifiable*

loss as a result of a respondent's misconduct. . . ." Principle 5, at 4 (emphasis added). In footnote 55 of its opinion, the SEC offered the following explanation of this causation requirement:

> In requiring that a loss be *a* result rather than *the* result of a respondent's misconduct, we acknowledge that other factors may bear upon the loss and that any determination as to the propriety of restitution will be based on an analysis of all the relevant facts and circumstances.

SEC Decision, 2008 SEC LEXIS 2459, at *51 n.55, 2 J.A. 698 (underscoring in original). "[T]his explanation is nonsense, and the two [phrases] together are not even compatibly nonsensical." *Allentown Mack Sales & Serv., Inc. v. NLRB,* 522 U.S. 359, 376 (1998). Whether a loss is the sole result or one of many results of a broker's misconduct is irrelevant to the causation issue raised by Siegel. Moreover, the second part of footnote 55 does not even reflect an acknowledgment by the Commission that Principle 5 requires some meaningful causal connection between a broker's misconduct and the losses suffered by his clients. Rather, in footnote 55, the Commission does no more than assert that it will decide whether to impose restitution on the basis of "an analysis of all the relevant facts and circumstances." *SEC Decision,* 2008 SEC LEXIS 2459, at *51 n.55, 2 J.A. 698. This explanation tells neither the reviewing court nor the regulated parties anything about (1) the degree of causal connection that the Commission will require

between proven misconduct and a loss before imposing 100% restitution, or (2) how the Commission intends to measure the substantiality of that connection. This is entirely unacceptable. As the Court noted in *Allentown Mack,* "[n]ot only must an agency's decreed result be within the scope of its lawful authority, but the process by which it reaches that result must be logical and rational." 522 U.S. at 374.

The SEC based its decision on the proposition that "as between Siegel's customers, who were placed in unsuitable investments and Siegel, who recommended them, equity requires Siegel, as the person responsible for the losses, to bear the burden and to return the customers to the position occupied prior to the unsuitable recommendations." *SEC Decision,* 2008 SEC LEXIS 2459, at *50, 2 J.A. 698. The agency's own analysis, however, makes clear that the unsuitability of the recommendations stemmed not from a level of risk associated with the investments that the customers were otherwise unwilling to bear, but rather from the terms of the investment offering documents, which were deficient. Tellingly, there is nothing in the SEC decision demonstrating that the customers' losses came "as a result of" these document deficiencies. Indeed, had the investment paperwork that Siegel provided to his clients not been deficient, the Downers and the Landrys still would have suffered the same losses once World ET failed. Moreover, in resting its analysis on the deficient offering documents, the SEC declined to address "whether World ET was suitable for the Downers and the

Landrys based upon their personal situations." *Id.* at *31 n. 26, 2 J.A. 690.

In failing to articulate a comprehensible principle governing the level of causation required by Principle 5, the SEC decision borders on whimsical or rests on notions of strict liability. In either event, the decision offers no reasonable construction of the causation requirement under Principle 5. This is far short of reasoned decisionmaking. As the Supreme Court has explained, the "evil of a decision" of this sort is that it "prevent[s] both consistent application of the law by subordinate agency personnel . . . and effective review of the law by the courts." *Allentown Mack,* 522 U.S. at 375. The SEC's decision in this case clearly fails for want of reasoned decisionmaking.

* * *

Although not supported by reasoned decisionmaking, the SEC's judgment on restitution arguably might survive review if supported by controlling precedent that included reasoned decisionmaking. However, the SEC has cited no such precedent, and we have found none, supporting restitution under Principle 5 in a case of this sort.

As noted above, this case involves wealthy and sophisticated customers who were not pressed to decide whether to invest; customers who invested in furtherance of their specific desires to speculate in a high risk venture; and a broker who did not profit from his wrongdoing and who has been fined and suspended for his violations. The SEC has never

ordered restitution in a situation such as this. Indeed, all of the cases cited by the SEC indicate that restitution has been ordered only in situations in which causation is clear, *i.e.,* there has been proof that the amount charged in restitution is closely and inextricably tied to the amount lost as a result of the broker's wrongdoing.

During oral argument, SEC counsel was asked to cite the case that best supports the SEC position in this case. Counsel cited *In re Dane S. Faber,* Exchange Act Release No. 49,216 (Feb. 10, 2004), 2004 SEC LEXIS 277, a decision not relied upon by the SEC. The case involved restitution sanctions in a situation in which the agency found fraudulent and unsuitable recommendations in violation of SEC Rule 10b-5 and NASD rules. The agency found that the broker-dealer had "recommended that a financially inexperienced customer of modest means preparing for retirement invest nearly all of her portfolio (which constituted more than two-thirds of her total liquid assets) in a single speculative security *despite her instructions that she wanted conservative investments.*" *Id.* at *28 (emphasis added). *Faber* obviously gives no support to the SEC's judgment in this case.

The SEC decision cites to three cases: *In re Toney L. Reed,* Exchange Act Release No. 33,676 (Feb. 24, 1994), 1994 SEC LEXIS 507 ("*Reed I*"); *In re Toney L. Reed,* Exchange Act Release No. 34-37,572 (Aug. 14, 1996), 1996 SEC LEXIS 2208 ("*Reed II*"); and *In re David J. Dambro,* Exchange Act Release No. 32,487

(June 18, 1993), 1993 SEC LEXIS 1521. These cases do not support the SEC's judgment in this case.

The *Reed* cases involved a broker-dealer whose company charged excessive markups to his customers when selling securities. The NASD ordered Reed, the president and general securities principal of a securities firm, to pay restitution to customers to cover the value of the excessive markups in the sale of securities. Reed contested restitution on the grounds that he could not be ordered to "disgorge" profits that NASD had not proved he actually possessed, an argument the agency rejected. The SEC's decision in the *Reed* cases surely does not support its decision in this case. *Reed* compares restitution with disgorgement, but it does not speak to the causation part of the restitution inquiry. While *Reed* clarifies that "an order for restitution can seek to restore the customer's position by returning the amount by which the customer was deprived," the SEC also makes it clear that restitution is appropriate only insofar as "equity would demand that the wrongdoer, rather than the customer, bear the loss." *Reed I*, 1994 SEC LEXIS 507, at *13. The losses suffered by Reed's clients were attributable solely to Reed's impermissible price markups. As the SEC noted, "it is equitable to require [Reed] to compensate those he injured by his pricing determinations" because Reed was the president and a significant owner of the firm and was also "the individual who was involved actively in both the purchase of the stock for the Firm and the resale of that stock to the Firm's customers at excessive

prices." *Reed II,* 1996 SEC LEXIS 2208, at *4. The agency also noted that Reed had notice of this potential outcome, because the NASD Guidelines specify that in a markup case, "consideration should be given to requiring restitution to customers of the excess amount of the markup." *Id.*

The SEC's decision in *Dambro* is similarly inapposite. In that case, a broker-dealer used an aggressive, "cold call" approach to contact an elderly retiree, and in that single call recommended the purchase of 670,000 shares of a highly speculative stock. The retiree had a net worth of about $400,000 and an annual income of around $50,000. The SEC noted that, "[d]espite the high level of risk to which [the retiree's] $10,000 would be subject, Dambro made only a cursory inquiry into whether such an undertaking accorded with [the retiree's] objectives." *Dambro,* 1993 SEC LEXIS 1521, at *7. The agency also agreed with NASD that "the sale of a highly speculative security which had exhibited little evidence of profit potential to a person of advanced age is inherently suspect." *Id.* at *11 (internal quotation marks and citation omitted).

The situation faced by the Downers and the Landrys bears little resemblance to the scenarios in these cases. In the *Reed* cases, the customers' losses were the direct result of impermissible markups, and restitution was imposed against the president and general securities principal of the firm. In *Dambro* and *Faber,* the losses resulted from speculative, high-risk investments that were pressed on customers for

whom such investments obviously were inappropriate. In this case, the losses resulted when World ET – a high risk, start-up company – failed. But the unsuitability of Siegel's recommendations stemmed from inadequate documentation, not the nature of the company itself. The SEC did not find that World ET was unsuitable for the Downers and the Landrys based upon their personal situations.

Moreover, the Downers and the Landrys themselves bear little resemblance to the victims in the cases cited by the SEC. There is no evidence that the customers in the *Reed* cases knowingly put themselves in a position to be swindled by a broker who charged excessive markups. In *Dambro,* the customer lost money in a highly speculative investment that was pressed upon him by an aggressive broker who made no assessment of the customer's risk tolerance. In *Faber*, the speculative investment was recommended despite the customer's explicit aversion to risk. By comparison, the Downers were looking to speculate and obviously understood they could lose their money if World ET failed. Indeed, Huntington Downer indicated that he was aware of the speculative nature of his investment; and he conceded that he had "not heard of investments paying" at the rate suggested by Siegel for the World ET and World IEQ investments "unless all of the sudden you hit it lucky." NASD Arbitration Tr. (Apr. 14, 2004), *reprinted in* 2 J.A. 600. The Landrys testified that Siegel "did not pressure them to invest." *SEC Decision,* 2008 SEC LEXIS 2459, at *12, 2 J.A. 682. And

Dorothy Landry acknowledged that, in her mind, the World ET investment "was just as much of a gamble as if I had taken it to the gulf coast and put it down on a slot machine"; she added that, "if I was to take 10 percent of my money and go to the casino, I would have just as much chance of bringing some home as I'm going to have as I give it to this thing." NASD Arbitration Tr. (Apr. 13, 2004), *reprinted in* 2 J.A. 603. In response to these damning admissions, the SEC merely says, "[e]ven where a customer seeks to engage in a highly speculative investment, a registered representative has a duty to refrain from making unsuitable recommendations." *SEC Decision,* 2008 SEC LEXIS 2459, at *53, 2 J.A. 699. While that may be true, it speaks only to the question of liability; it does not relieve the agency of its obligation to show a meaningful causal relationship between the amount ordered to be paid in "restitution" (as distinguished from fines) and sanctionable wrongdoing.

In this case, sophisticated investors willingly sought to invest their money in a highly speculative venture involving a start-up company that eventually failed. The SEC has cited no controlling precedent that includes reasoned decisionmaking supporting restitution under Principle 5 in a case of this sort. We therefore vacate the restitution order. The SEC's failure to coherently analyze the extent to which the losses were truly a result of Siegel's misconduct is an abuse of discretion.

III. CONCLUSION

The petition for review is denied in part and granted in part. We deny Siegel's challenges to the SEC's finding that he violated Rule 2310 with respect to his dealings with the Downers. We also deny Siegel's challenges to the fines and consecutive suspensions imposed by NAC and upheld by the SEC in connection with his violations of Rules 3040, 2310, and 2110. We grant Siegel's petition for review challenging the SEC order upholding NAC's imposition of restitution. For the reasons given in this opinion, we find that the SEC's judgment awarding full restitution was neither adequately explained in its decision nor supported by agency precedent. We therefore vacate the restitution order. The case is remanded to the agency for a prompt disposition of this matter consistent with this opinion.

United States Court of Appeals
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 08-1379 **September Term, 2009**
FILED ON: JANUARY 12, 2010

MICHAEL FREDERICK SIEGEL,
PETITIONER

V.

SECURITIES AND EXCHANGE COMMISSION,
RESPONDENT

On Petition for Review of an Order
of the Securities & Exchange Commission

Before: GARLAND, *Circuit Judge*, and EDWARDS and RANDOLPH, *Senior Circuit Judges*.

JUDGMENT

This cause came on to be heard on the petition for review of an order of the Securities & Exchange Commission and was argued by counsel. On consideration thereof, it is

ORDERED and **ADJUDGED** that the petition for review is granted in part and is denied in part; and the restitution order is vacated and the case is remanded to the agency for prompt disposition of this

matter, in accordance with the opinion of the court filed herein this date.

Per Curiam

FOR THE COURT:
Mark J. Langer, Clerk

BY: /s/
Michael C. McGrail
Deputy Clerk

Date: January 12, 2010

Opinion for the court filed by Senior Circuit Judge Edwards.

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 58737/October 6, 2008

Admin. Proc. File No. 3-12659

In the Matter of the Application of

MICHAEL FREDERICK SIEGEL
c/o George C. Freeman, III
Barrasso Usdin Kupperman
Freeman & Sarver, LLC
909 Poydras Street, Suite 2400
New Orleans, Louisiana 70112

For Review of Disciplinary Action Taken by

NASD

OPINION OF THE COMMISSION

REGISTERED SECURITIES ASSOCIATION – REVIEW OF DISCIPLINARY PROCEEDINGS

Violations of Conduct Rules

Failure to Provide Written Notice to Member Firm Employer Regarding Private Securities Transactions

Unsuitable Recommendations

Conduct Inconsistent with Just and Equitable Principles of Trade

Registered representative of member firm of registered securities association participated in private securities transactions without providing prior written notice to his member-firm employer,

made unsuitable recommendations, and, as a result, engaged in conduct inconsistent with just and equitable principles of trade. *Held*, association's findings of violations and sanctions are *sustained*.

APPEARANCES:

George C. Freeman, III and *Meredith A. Cunningham*, of Barrasso Usdin Kupperman Freeman & Sarver, LLC, for Michael Frederick Siegel.

Marc Menchel, James S. Wrona, and *Michael J. Garawski*, for FINRA.

Appeal filed: January 3, 2008
Last brief received: April 24, 2008

I.

Michael Frederick Siegel, formerly a general securities representative associated with Rauscher Pierce Refsnes, Inc. ("Rauscher"), an NASD member firm, appeals from NASD disciplinary action.[1] NASD found that Siegel engaged in private securities

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[1] On July 26, 2007, the Commission approved a proposed rule change filed by NASD to amend NASD's Certificate of Incorporation to reflect its name change to Financial Industry Regulatory Authority, Inc., or FINRA, in connection with the consolidation of the member firm regulatory functions of NASD and NYSE Regulation, Inc. *See* Securities Exchange Act Rel. No. 56146 (July 26, 2007), 91 SEC Docket 517. Although FINRA issued the Supplemental Decision on restitution, NASD initiated the original disciplinary action. We will we [sic] continue to use the designation NASD.

transactions without providing prior written notice to Rauscher in violation of NASD Conduct Rules 3040 and 2110.[2] NASD also found that Siegel made unsuitable recommendations to two couples in violation of NASD Conduct Rules 2310 and 2110. NASD fined Siegel a total of $30,000, ordered him to serve consecutively two six-month suspensions in all capacities, ordered restitution to the customers at issue in the amount of $400,300, and assessed costs of $7,958.05. We base our findings on an independent review of the record.

II.

Siegel's Involvement with World Environmental Technologies, Inc.

Siegel has been registered as a general securities representative since 1981 and was associated with Rauscher from October 24, 1997 until June 16, 1999.[3]

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[2] NASD Conduct Rule 3040(e)(1) defines "private securities transaction" as "any securities transaction outside the regular course or scope of an associated person's employment with a member, including, though not limited to, new offerings of securities which are not registered with the Commission, provided however that transactions subject to the notification requirements of Rule 3050, transactions among immediate family members (as defined in Rule 2790), for which no associated person receives any selling compensation, and personal transactions in investment company and variable annuity securities, shall be excluded."

[3] Siegel also has been active as a radio and television personality providing investment advice since the mid-1980s, a

(Continued on following page)

At the beginning of 1997, Siegel met World Environmental Technologies, Inc. ("World ET") president, Jim Finkenkeller, and the chairman of World ET's board, Tom Denmark, to discuss a business opportunity. During several meetings with Finkenkeller and Denmark over the next three or four months, Siegel learned that World ET recently had been founded to offer antibacterial services to the poultry and swine industry and intended to acquire the rights to an odor-eradicating product called "Nok-Out."

Sometime in late 1997, Siegel agreed to become a director of World ET and to raise capital for the Nok-Out venture. He believed that, as a director, he would be well positioned to be selected for the company's potential initial public offering. In a letter dated October 22, 1997, Finkenkeller informed Siegel that World ET immediately required Siegel's fundraising efforts in connection with, among other things, fulfilling a "$200,000 commitment" and obtaining "operating capital" and that Siegel could show his "investors" a "small job" that World ET was to perform at the end of the month.

On November 24, 1997, Siegel requested in writing permission from Rauscher to serve as a director of World ET. Siegel represented that he was not recommending World ET securities to his customers. Rauscher granted Siegel permission to serve

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registered investment adviser since 1999, and the author of a book entitled, "Investing for Cowards," published in 2001.

as a director but informed Siegel that he would "not be able to effect transactions in the securities of World [ET]. . . ." At the hearing, Siegel testified that his supervisor, Scott Grandbouche, told him that it was highly unlikely that Rauscher would ever approve a Rauscher registered representative selling unregistered securities.[4] Rauscher never approved Siegel's offer or sale of World ET securities.

On December 6, 1997, Finkenkeller sent Siegel a draft employment agreement that provided that Siegel would use his best efforts to obtain, by March 31, 1998, at least $15 million to fund World ET's "development and operations" in exchange for payments of cash and stock. Siegel signed the agreement in January 1998. In the executed agreement, Siegel substituted his home address for his office address for the purpose of receipt of all "notices, demands, and requests" under the agreement ("Notice Provision"). Grandbouche testified that all mail received through the firm was opened and reviewed by administrative personnel before being delivered to a registered representative. Siegel never informed Rauscher about his employment agreement with World ET.

When Siegel signed the employment agreement, he also loaned World ET $22,000. On March 6, 1998,

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[4] Siegel testified that he later told Grandbouche that his "clients wanted to invest in World ET [and] do it on their own," but Grandbouche denied that Siegel told him anything about the transactions at issue.

Siegel loaned World ET an additional $20,166.01. Siegel testified that he was unclear about what repayment terms, interest rates, or maturity dates applied to the loans he made to World ET. World ET failed to pay Siegel for his services as a director or pursuant to the employment agreement or to repay any portion of his two loans to the company.

Siegel's Dealings with the Downers

Huntington and Linda Downer had been investing with Siegel since 1993.[5] Siegel had discretion over their account. Over time, Siegel invested their funds in a combination of fixed-income products, mutual funds, and stock.[6] The Downers testified that they had invested mainly in certificates of deposit prior to investing with Siegel and "looked to him for financial guidance."

Seven days after Siegel became associated with Rauscher in October 1997, the Downers transferred all of their holdings from their account maintained at Siegel's previous firm to a new discretionary joint account with Rauscher. In early November 1997,

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[5] Huntington Downer earned $150,000 annually as a legislator and focused on finance and budget issues. Downer previously had been a partner in a law firm. Linda Downer, his wife, had no separate income. The Downers had a net worth of approximately $1.5-2.0 million, excluding their home.

[6] The Downers relied on the income generated from their investments and sought growth and income as their investment objective.

Siegel visited the Downers' home to discuss their account, as he had done routinely since they began investing with him. During the visit, Siegel brought up World ET. He told the Downers that World ET was a new company and that he was going to invest in the company. Siegel also told the Downers that World ET planned on acquiring the rights to "Nok-Out." He said that he was very excited about the formula (which he described to them) and gave them a sample of "Nok-Out" to use on their cat's litter box. Based on Siegel's representation that he was investing in World ET, Huntington Downer asked Siegel to contact the company to inquire about any investment opportunities for the Downers. Following the visit, Siegel spoke with Finkenkeller or Denmark who informed him that the Downers could invest $300,000 in World IEQ Technologies, Inc. ("World IEQ"), purportedly a subsidiary of World ET. Siegel conveyed this information to the Downers who asked him to obtain the relevant paperwork on their behalf.

On November 24, 1997, Siegel visited the Downers a second time and brought with him several documents related to World IEQ. The World IEQ subscription agreement provided that the subscriber waived the right to receive a document "typically called a Prospectus or Private Placement Memorandum." It also provided that a subscriber's $300,300 investment would purchase a 120-day debenture for $300,000 plus 300,000 shares of World IEQ common stock for $300 at $0.001/share. The World IEQ questionnaire, in contrast, requested that the subscriber

confirm the purchase of a 365-day debenture for $300,000 plus 300,000 shares of "Class Common Stock" without specifying a price. The documents contained no information regarding an interest rate or repayment terms for the debenture.

Siegel testified that he did not review or analyze any of the documents. Without completing any blank sections or discussing the contents of the documents with Siegel, Huntington Downer signed and returned to Siegel the World IEQ subscription agreement and the World IEQ questionnaire. Huntington Downer testified that he often signed documents that Siegel provided without reviewing them or questioning Siegel.[7] Linda Downer gave Siegel a personal check made payable to World IEQ in the amount of $300,300. She testified that, "I know that sounds really strange to invest $300,000 [sic] in something that you know nothing about, but . . . I trusted [Siegel] to do whatever." Siegel faxed the forms to World ET.

Shortly thereafter, the Downers decided to pay for the World IEQ investment by using funds from their Rauscher account instead of paying with the check that Linda Downer wrote and which was never

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[7] For example, Huntington Downer testified, "Mr. Siegel was my friend. He would come to my house. He would give me recommendations. Whatever he said, whatever he put in front of me, I signed. I trusted him implicitly. I never once filled out any forms, to the best of my recollection. He filled out whatever and showed me where to sign, and I signed."

negotiated. Siegel provided, and the Downers signed, a letter dated November 28, 1997 that authorized him to wire $300,300 from their Rauscher account to a World IEQ bank account in Texas. Rauscher effected the wire transfer on December 1, 1997.

Approximately one or two weeks later, Finkenkeller called Siegel and told him that the Downers could no longer invest in World IEQ and had the option of receiving a refund or investing in World ET. Siegel conveyed this information to the Downers. When Huntington Downer asked Siegel for advice on how to decide, Siegel stated that he "would rather be in the mother company if [he] had a choice." The Downers told Siegel that they opted to invest in World ET. Siegel was the Downers' only source of information regarding their decision to invest in World IEQ and World ET.

Siegel's Contacts with the Landrys

Dorothy and Barry Landry opened a Rauscher account with Siegel in November 1997 based on a referral by Huntington Downer. The Landrys vested Siegel with discretion over their account. The Landrys sought to increase the return on $1 million that they acquired from the recent sale of their healthcare business. Siegel told them that he subsequently might recommend that they invest in higher-risk, start-up companies.

Later that month, Siegel visited the Landrys' home to complete some follow-up paperwork

regarding their new account and to discuss their portfolio. Siegel raised the topic of World ET, stating that he thought it was something in which they might be interested and that he wanted them "to take a look at" the company. Siegel told them that World ET was a new company that intended to introduce Nok-Out to the poultry and swine industry and that he and the Downers were investing "three times" the minimum investment amount in the company.

The Landrys testified that, while Siegel did not pressure them to invest, he did "promote the benefits of [Nok-Out]" and assure them that "this looked like a really good deal." For example, Dorothy Landry testified that Siegel told them that Nok-Out "looked like a product that . . . is going to be needed" and "is going to have lots of sales," that it "could be global," that "the opportunities existed to get in on the ground floor," and that "distribution is going to be coast-to-coast almost immediately because of the nature of the poultry and swine industries." Barry Landry testified that Siegel told them that he "knew of a company [i.e., World ET] that was on its ground floor getting started up and might be a nice place to invest some money," and that "it looked like a good idea." Dorothy Landry testified that Siegel told the couple that the minimum investment amount was $100,000 and that they could get their money back in as little as ninety days or perhaps one year.

Dorothy Landry asked Siegel to call World ET to determine whether any investment opportunity existed. Siegel said he would be "glad to" and called

Denmark when he returned to his office. After speaking with Denmark, Siegel told the Landrys that they could invest in World ET.

On a subsequent visit a couple of weeks later, Siegel gave the Landrys a folder containing World ET documents and including Siegel's Rauscher business cards.[8] Siegel testified that he did not review the documents or discuss them with the Landrys. A World ET subscription agreement provided that a subscriber could invest in a debenture at $100,000 per "unit" and would waive the right to receive a document "typically called a Prospectus or Private Placement Memorandum." A World ET strategic plan described World ET's first-year plan to provide odor- and bacteria-combating services to the swine industry, with a "[s]econdary focus" in the poultry industry. Siegel also gave the Landrys a World ET outline and a World ET "pro forma summary information" statement that contained conflicting repayment terms. None of the documents contained information about an interest rate or a maturity date for the debenture.

On Siegel's advice, the Landrys kept the documents to review for a couple of months before making a decision on whether to invest in World ET.

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[8] The record is unclear as to whether the information related directly to World ET or to a subsidiary whose name was listed inconsistently in the documents. Resolution of this issue is not relevant to our disposition of Siegel's appeal. However, in the interest of clarity, we will use the designation World ET.

Dorothy Landry testified that Siegel's planned investment in World ET led them to the conclusion that, "if [Siegel] was interested in it, consider it solid." The Landrys testified that learning from Siegel that the Downers had invested in World ET further validated their decision to invest.

On February 5, 1998, the Landrys faxed to Rauscher and Siegel a request to wire transfer $100,000 from their Rauscher account to their joint bank account with Hibernia National Bank, which Rauscher effected on that same day. On February 11, 1998, the Landrys gave the signed World ET subscription agreement and a $100,000 check made payable to World ET to Siegel, who sent them to World ET. World ET negotiated the check. Siegel was the Landrys' only source of information about World ET prior to making their investment decision.

World ET Goes Out of Business

Pursuant to an arbitration decision rendered on August 28, 2002, World ET lost the rights to Nok-Out because World ET defaulted on payments it owed to the company that had developed the product. On February 13, 2004, the Texas Secretary of State revoked World ET's corporate charter. The Downers and Landrys never received any payments of any kind on their World ET investments.

Siegel's Testimony at the Hearing

Siegel testified that he believed the Downers invested in World IEQ because he told them that he was going to invest in World ET. Siegel further testified that the World IEQ and World ET documents that he provided to the Downers and Landrys were deficient because they either lacked or contained conflicting or confusing information about details that private placement transaction documents typically specify, such as maturity dates, interest rates, and repayment terms.

Siegel conceded at the hearing that these documentary deficiencies rendered an investment in World IEQ and World ET unsuitable for the Downers, the Landrys, or any investor. For example, Siegel agreed with an NASD hearing panelist who commented at the hearing that, with respect to the World IEQ and World ET documents, "[t]his is one of the worst sets of offering documents I have ever seen in my life. I mean you can't tell what these people are investing in." Siegel also stated, "I didn't know how bad they were because I was trying to not sell away. . . . Had I looked over the documents, yes, I probably would have been discouraged with the company right then and there. I didn't look them over. I wish I had." Siegel did not claim at any time during the proceeding, and the record does not indicate, that his communications with Finkenkeller or Denmark or his position as a World ET director provided him any additional information about the

potential risks and rewards associated specifically with a World ET investment.

Procedural Background

On November 26, 2002, NASD's staff filed a complaint against Siegel alleging that he engaged in private securities transactions without providing prior written notice to Rauscher and that he made unsuitable recommendations to both the Downers and the Landrys. On April 19, 2004, an NASD Hearing Panel found that Siegel had committed the violations alleged in the complaint. The Hearing Panel fined Siegel $30,000 and ordered him to serve concurrently two six-month suspensions in all capacities.

Siegel appealed and NASD staff cross-appealed the decision to NASD's National Adjudicatory Council ("NAC"). On July 26, 2005, the NAC remanded the proceeding and ordered the Hearing Panel to make credibility determinations and supplemental findings as to Siegel's interactions with the Landrys.

On May 11, 2007, the NAC affirmed the Hearing Panel's March 16, 2006 findings of violation and credibility determination in favor of the Landrys. The NAC also affirmed the Hearing Panel's sanctions, except that it ordered Siegel to serve his suspensions consecutively and to pay restitution to the Downers and Landrys in the amount of $400,300. The NAC found that the record evidence was insufficient to make a determination whether the restitution

amount was subject to offset. Accordingly, the NAC ordered a NAC Subcommittee to make a recommendation to the NAC regarding the offset amount.

The NAC Subcommittee denied Siegel's request for an in-person evidentiary hearing. Siegel did not dispute that the Downers and the Landrys never sold their investments in World securities, that their World securities have no residual value, and that they recovered no restitution through other avenues. Based on documentary evidence, including affidavits submitted by Siegel and NASD staff, the NAC subcommittee recommended that no offset be imposed. On that basis, the NAC concluded that no offset was required in its supplemental decision dated December 4, 2007.

III.

Pursuant to Section 19(e) of the Securities Exchange Act of 1934, we will sustain NASD's decision if the record shows by a preponderance of the evidence that Siegel engaged in conduct that NASD found to have violated its rules and that NASD applied its rules in a manner consistent with the purposes of the Exchange Act.[9]

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[9] 15 U.S.C. § 78s(e).

Private Securities Transactions

NASD Conduct Rule 3040 prohibits an associated person from participating "in any manner" in a private securities transaction without prior written notification to the employer, *i.e.*, selling away.[10] Siegel does not dispute that he violated NASD Conduct Rule 3040. Siegel stipulated before NASD that the investments made by the Downers and Landrys in World ET involved securities.[11] Siegel admits that he participated in the private securities transactions at issue. Among other things, he introduced World ET to the customers, was the customers' sole source of information about World ET prior to their investments, and facilitated their purchases of World

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[10] *Joseph Abbondante*, Exchange Act Rel. No. 53066 (Jan. 6, 2006), 87 SEC Docket 203, 214, *aff'd*, 209 Fed. Appx. 6 (2nd Cir. 2006) (Unpublished); NASD Manual at 4836-37 (1998). NASD Conduct Rule 3040 also provides that if an associated person is to receive selling compensation, he must give prior written notice to the firm and receive written approval before engaging in the transaction. NASD stipulated that it did not contend that Siegel received any commission or other compensation in connection with any investments made by the customers at issue in World ET or its subsidiaries. Thus, selling compensation is not an issue in this proceeding.

[11] Exchange Act Section 3(a)(10) defines the term "security" to include "any" "stock" or "debenture." 15 U.S.C. § 78c(a)(10). The subscription agreements signed by the Downers and the Landrys each stated that an investment resulted in the purchase of a debenture, as well as stock. The parties do not dispute that each of the World ET investments purchased by the Downers and the Landrys was a security. We agree with NASD's finding that these investments were securities.

ET.[12] Siegel further admits that he did not provide prior written notice to Rauscher of his participation in the sales activity at issue.

Accordingly, we find that Siegel participated in private securities transactions without providing prior written notice to Rauscher in violation of NASD Conduct Rules 3040 and 2110.[13]

Unsuitable Recommendations

Siegel Made Recommendations. NASD Conduct Rule 2310 requires that a transaction recommended by a registered representative to a customer be suitable. Whether the communication between a registered representative and a customer constitutes a recommendation is a "'facts and circumstances' inquiry to be conducted on a case-by-case basis."[14] Such an inquiry "requires an analysis of the content,

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[12] *See Abbondante*, 87 SEC Docket at 216 (finding that applicant participated in private securities transactions by introducing security to customers, being the sole source of information about the security, and facilitating purchase of security).

[13] NASD Conduct Rule 2110 requires NASD members to observe high standards of commercial honor and just and equitable principles of trade. NASD Manual at 4111. NASD General Provisions Rule 115 extends the applicability of NASD rules governing members to their associated persons. It is well settled that a violation of a Commission or NASD rule or regulation also constitutes a violation of Conduct Rule 2110. *E.g., Stephen J. Gluckman*, 54 S.E.C. 175, 185 (1999).

[14] *NASD Notice to Members*, 01-23 (Apr. 2001).

context, and presentation of the particular communication."[15] NASD has stated that factors considered in conducting this inquiry include whether the communication "reasonably could be viewed as a 'call to action' and "reasonably would influence an investor to trade a particular security or group of securities."[16] For the reasons set forth below, we find that Siegel's communications with the Downers and the Landrys constitute recommendations.

The nature of the relationship between Siegel and his customers, their reliance on him, the nature of the specific conversations, and Siegel's initiation of the subject of World ET are the main factors supporting a finding that Siegel made recommendations. Siegel visited the Downers' home in November 1997 to discuss their portfolio. Siegel raised the topic of investing in World ET during that discussion. The Downers had never heard of World ET. Siegel was the Downers' sole source of information about the company. He told the Downers that he was very excited about Nok-Out. Siegel also told the Downers that he was going to invest in the company.[17]

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[15] *Id.*

[16] *Id.*

[17] Siegel testified that he also informed the Downers and the Landrys that he was going to become a director of World ET. The Downers and the Landrys testified that he did not disclose this fact. Resolution of this issue is not necessary for us to determine whether Siegel's communications with his customers were recommendations.

The Downers had sought Siegel's investment guidance for three years and routinely deferred to his decisions without question. Siegel admitted that he believed the couple invested in World ET because he told them that he planned on investing in the company. Siegel claims that his communications with the Downers were merely conversations about World ET, but we disagree.

Siegel made further inquiries, obtained and conveyed information, and facilitated execution of subscription documents and payment for the purchase of World IEQ shares. After Siegel informed the Downers that it was no longer possible to invest in World IEQ, he advised them to invest in World ET rather than receive a refund on their World IEQ investment, stating that he "would rather be in the mother company if [he] had a choice." Siegel admits that he could have refused Huntington Downer's request to obtain additional information about investing in World ET.

With respect to the Landrys, Siegel raised the topic of investing in World ET while reviewing their portfolio. He was the Landrys' sole source of information about the company prior to making their investment decision. Siegel told the Landrys that he and the Downers were investing "three times" the minimum investment amount in the company. The Landrys testified that the knowledge that Siegel and the Downers also were investing in World ET comforted them. He gave them glowing projections about its potential success. Siegel made encouraging

statements about the investment and proceeded on behalf of the Landrys to make further inquiries, obtain and convey information, deliver documents, return executed originals, and facilitate payment to World ET.

We find that Siegel's conduct constitutes a recommendation because it was a "call to action" that reasonably influenced the Downers and the Landrys to invest in World ET. The Downers and the Landrys relied on Siegel for investment advice. Within the context of Siegel's visits to the Downers and the Landrys to provide such advice, he introduced them to World ET, made encouraging statements about investing in World ET, and facilitated his customers' overall investments.

Siegel's Arguments. Siegel contends that the NAC improperly found that he made a recommendation to the Downers "only by ignoring key evidence." In support of that argument, he claims that the Downers "were able to distinguish a recommendation – a 'call to action' – from the mere mention of a company in personal conversation" because they are "among the most sophisticated investors under the law" and thus able to "fend for themselves." However, while sophistication of the investor may be relevant, sophistication alone does not mean that a communication is not a recommendation. Siegel did not merely mention World ET to the Downers. He repeatedly provided the Downers with positive details about the company and associated investment opportunities during ongoing

conversations that began in the context of his periodic review of their investments.

Siegel claims that Huntington Downer initiated the idea of investing in World ET and insisted on investing. However, Downer was aware of World ET only because Siegel brought it to his attention and spoke enthusiastically about its prospects. Siegel also claims that he told the Downers not to invest simply because he was investing and that they would be on their own if they did decide to invest and that he discouraged Huntington Downer from investing in World ET by advising him that "he would have to wait until the company went public." Yet, these statements do not change the conclusion that he made a recommendation. Siegel provided significant information and assistance to the Downers in making their investment in World ET while it was a non-public company, including encouraging them to invest in World ET after learning they could not invest in World IEQ.

Siegel asserts that, "[g]iven its election to forego any credibility findings as to the Downers, the NAC was required to constrain its review [regarding whether Siegel made a recommendation to the Downers] to Siegel's testimony." Siegel's argument is without merit. In the absence of a credibility finding with respect to the Downers' testimony, the NAC was required to conduct a *de novo* review and was permitted to make its findings based on a review of

the entire record.[18] We also have conducted a *de novo* review.[19]

Siegel does not dispute that he recommended an investment in World ET to the Landrys. The Hearing Panel credited the Landrys' testimony on this issue. It is well established that we defer to the credibility determination of a fact-finder.[20] We see no reason to question the Hearing Panel's determination here. We find that Siegel made recommendations to the Downers and the Landrys within the meaning of NASD Conduct Rule 2310.[21]

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[18] *See Michael B. Jawitz*, 55 S.E.C. 188, 200 & n.24 (2001) (stating that the NAC conducts a de novo review and has broad discretion to review any finding in the Hearing Panel decision) (citing *Timothy L. Burkes*, 51 S.E.C. 356, 359 (1993), *aff'd*, 29 F.3d 630 (9th Cir. 1994) (Table)); *cf. Morton Bruce Erenstein*, Exchange Act Rel. No. 56768 (Nov. 8, 2007), 91 SEC Docket 3114, 3126 (acknowledging the NAC's power to conduct a *de novo* review and make its own independent findings), *petition denied*, No. 07-15736 (11th Cir. 2008) (Unpublished).

[19] *See Keith Springer* 55 S.E.C. 839, 841 n.5 (2002) ("Our *de novo* review of the record [under Exchange Act Section 19(e)] permits us to make our own findings based on a review of all material in the record."); *Kenneth C. Krull*, 53 S.E.C. 1101, 1109 (1998), *aff'd*, 248 F.3d 907 (9th Cir. 2001).

[20] *E.g., Stephen Michael Sohmer*, 57 S.E.C. 240, 255 & n.27 (2004) (citation omitted).

[21] *Cf. Gordon Scott Venters*, 51 S.E.C. 292, 294 (1993) (finding that applicant made a recommendation within the meaning of NASD Conduct Rule 2310 where customer's interest in investment was whetted by salesperson's and firm's promotional campaign); *F.J. Kaufman and Co. of Va.*, 50 S.E.C. 164, 172 (1989) (finding that applicant made a recommendation

(Continued on following page)

Siegel's Recommendations Were Unsuitable. NASD Conduct Rule 2310 requires that, in recommending a transaction to a customer, a registered representative "shall have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs."[22] The suitability rule thus requires that, before making a customer-specific suitability determination, a registered representative must first have an "adequate and reasonable basis" for believing that the recommendation could be suitable for at least some customers.[23] The reasonableness of any recommendation is predicated on a registered representative's understanding of "the potential risks and rewards inherent in that

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within the meaning of the suitability rule where customers invested as a result of salesperson's substantial involvement and participation in the investment strategy).

[22] *Maximo Justo Guevara*, 54 S.E.C. 655, 662 (2000), *petition denied*, 47 Fed. Appx. 198 (3d Cir. 2002) (Table); *Rafael Pinchas*, 54 S.E.C. 331, 341 (1999); NASD Manual at 4261.

[23] *Terry Wayne White*, 50 S.E.C. 211, 212 & n.4 (1990) ("It is well established that a broker cannot recommend any security to a customer 'unless there is an adequate and reasonable basis for such recommendation,' and "[a] broker cannot conclude that a recommendation is suitable for a particular customer unless he has a reasonable basis for believing that the recommendation could be suitable for at least some customers"); *F.J. Kaufman and Co.*, 50 S.E.C. at 168 & n.16 (citing *Hanley v. SEC*, 415 F.2d 589, 597 (2d Cir. 1969) (a broker-dealer "cannot recommend a security unless there is an adequate and reasonable basis for such recommendation")).

recommendation."[24] We have stated that "a broker may violate the suitability rule if he fails so fundamentally to comprehend the consequences of his own recommendation that such recommendation is unsuitable for any investor, regardless of the investor's wealth, willingness to bear risk, age, or other individual characteristics."[25]

The record establishes, and Siegel does not dispute, that he had no basis, and certainly not a reasonable and adequate basis, for believing that his recommendations regarding an investment in World IEQ and World ET could be suitable for at least some customers. Siegel testified that he did not read any of the World IEQ and World ET documents that he provided to the Downers and the Landrys.

Even if Siegel had read them, he would not have had a reasonable basis for recommending World ET

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[24] *F.J. Kaufman and Co.*, 50 S.E.C. at 168 & n.18 (citing *Alexander Reid & Co.*, 40 S.E.C. 986, 990 (1962) (a broker's recommendation must be "responsibly made on the basis of actual knowledge and careful consideration"); *Distribution by Broker-Dealers of Unregistered Securities*, Exchange Act Rel. No. 6721 (Feb. 2, 1962) ("the making of recommendations for the purchase of a security implies that the dealer has a reasonable basis for such recommendations which, in turn, requires that, as a prerequisite, he shall have made a reasonable investigation")).

[25] *See F.J. Kaufman and Co.*, 50 S.E.C. at 169-71 (finding recommendation unsuitable for any investor where registered representative was unaware of implications of investment strategy and therefore should not have recommended such strategy).

securities. Siegel admitted at the hearing that the World IEQ and World ET documents that he provided to the Downers and the Landrys were deficient: they either lacked or contained conflicting or confusing information about details that private placement transaction documents typically specify, such as maturity dates, interest rates, and repayment terms. Siegel agreed with a Panelist's comment at the hearing that the material provided to the Downers and the Landrys was "one of the worst sets of offering documents" he had ever seen and that "you can't tell what these people are investing in." During the exchange with the Panelist, Siegel further testified that, had he reviewed the documents, he "probably would have been discouraged with the company right then and there." Siegel also conceded at the hearing that the deficiencies in the documents rendered an investment in World IEQ and World ET unsuitable for the Downers, the Landrys, or any investor, particularly because there was no other information on which a prospective investor could rely to make an investment decision.[26]

Accordingly, we find that Siegel made unsuitable recommendations to the Downers and the Landrys in violation of NASD Conduct Rules 2310 and 2110.

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[26] Because we have determined that Siegel did not have a reasonable basis for his recommendation of World ET, we do not address whether World ET was suitable for the Downers and the Landrys based upon their personal situations.

IV.

Exchange Act Section 19(e) provides that we may cancel, reduce, or require the remission of a sanction imposed by NASD where we find, having due regard for the public interest and the protection of investors, that NASD's sanctions are excessive or oppressive or impose an unnecessary or inappropriate burden on competition.[27] Siegel claims that NASD's sanction determinations were "result-driven" because NASD took "irreconcilable positions as to cases it previously decided" and "misappl[ied] the Sanction Guidelines in a way it had not previously applied them." As an initial matter, it is well established that "[b]ecause the selection of an appropriate sanction depends on the facts and circumstances of each particular case, action taken in other proceedings is not determinative."[28] In this case, in view of the seriousness of Siegel's conduct, we believe that the sanctions imposed by NASD are neither excessive nor oppressive and that NASD properly applied the Sanction Guidelines.

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[27] 15 U.S.C. § 78s(e)(2). Siegel does not claim, and the record does not show, that NASD's action imposed an undue burden on competition.

[28] *See Robin Bruce McNabb*, 54 S.E.C. 917, 927 & n.38 (1999) (citing *Butz v. Glover Livestock Comm'n Co.*, 411 U.S. 182, 187 (1976); *Edward C. Farni II*, 51 S.E.C. 1118, 1120 n.11 (1994)), *aff'd*, 298 F.3d 1126 (9th Cir. 2002).

A. Suspensions and Fines

1. NASD Conduct Rule 3040 Violations

NASD fined Siegel $20,000 and suspended him in all capacities for six months for having violated NASD Conduct Rules 3040 and 2110. NASD's Sanction Guidelines ("Sanction Guidelines") recommend a fine of $5,000 to $50,000 and a suspension of three to six months for selling-away violations involving sales totaling $100,000 to $500,000.[29] The fine and suspension are within the recommended range.[30]

NASD identified several aggravating factors present in this case. Siegel sold $400,300 in World ET and World IEQ securities – an amount at the high end of the relevant range of $100,000 to $500,000. He was affiliated with World ET as a director and an

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[29] Sanction Guidelines at 15 (2006 ed.).

[30] The Sanction Guidelines have been promulgated by NASD in an effort to achieve greater consistency, uniformity, and fairness in the sanctions that are imposed for violations. Sanction Guidelines at 1. Since 1993, NASD has published and distributed the Sanction Guidelines so that members, associated persons, and their counsel will have notice of the types of disciplinary sanctions that may be applicable to various violations. *Id.* The Guidelines are not NASD rules that are approved by the Commission, but NASD-created guidance for NASD Adjudicators, which the Guidelines define as Hearing Panels and the National Adjudicatory Council. *Id.* Although the Commission is not bound by the Sanction Guidelines, it uses them as a benchmark in conducting its review under Exchange Act Section 19(e)(2).

employee.[31] Siegel's sales of World ET and World IEQ securities injured his customers – who were customers of Rauscher. He attempted to conceal his sales activity by failing to inform Rauscher about his employment agreement with World ET and changing his address in the Notice Provision of his employment agreement with World ET, preventing Rauscher from discovering the extent of his involvement with the issuer.[32] Siegel directly participated in the sales at issue.[33]

Siegel claims that he did not receive or expect financial benefit from his customers' investments. However, his activities on World ET's behalf had the potential for monetary or other gain from his roles at World ET as a director, creditor, and employee, as well as the potential of Rauscher's underwriting a future initial public offering.

Contrary to Siegel's contention, he did not provide verbal notice of the details of his sales

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[31] NASD further determined that, "[a]lthough Siegel disclosed to [the Downers] that he had applied to become a member of the World ET board of directors, he did not disclose to [the Landrys] that he had done so or that he had become a member of its board."

[32] *See* text following note 4 *supra*.

[33] Although Siegel claims that he did not sell World ET securities directly to the Downers and the Landrys, his conduct in connection with his customers' purchases, described at length above, evidences a significant involvement.

activities to his firm.[34] Moreover, he ignored a warning from his firm not to sell World securities. Siegel argues that Rauscher's warning not to sell World ET securities applied "only if World were to go public." However, Siegel proffers no evidence in support of this assertion, and Rauscher made no such statement in its written permission for Siegel to become a director. Moreover, Siegel admitted at the hearing that Grandbouche informed him that it was highly unlikely that Rauscher would ever approve a sale of unregistered securities, such as World ET. In any event, Siegel is responsible for compliance with regulatory requirements and cannot shift his responsibility for compliance to his supervisors.[35]

We have held repeatedly that selling away is a serious violation. "Conduct Rule 3040 is designed not only to protect investors from unsupervised sales, but also to protect securities firms from liability and loss

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[34] Siegel cites his testimony that he told his supervisor, Scott Grandbouche, that "these clients wanted to invest in World ET [and] do it on their own." However, Grandbouche testified that Siegel told him nothing about any of the transactions at issue even crediting Siegel's testimony, the information he conveyed lacks the required details of his sales activities, and therefore, it does not constitute verbal notice to the firm. *Cf. Chris Dinh Hartley*, 57 S.E.C. 767, 775 (2004) (finding that failure to provide the firm with the necessary details about the investments and sales activities at issue was not verbal notice).

[35] *See Philippe N. Keyes*, Exchange Act Rel. No. 54723 (Nov. 8, 2006) SEC Docket 792, 801 n.19 and accompanying text.

resulting from such sales. Such misconduct deprives investors of a firm's oversight, due diligence, and supervision, protections investors have a right to expect."[36] Siegel sidestepped his firm's protections and supervision. Siegel's misconduct illustrates the potential for harm to public investors through private securities transactions.[37]

2. NASD Conduct Rule 2310 Violations

NASD fined Siegel $10,000 and suspended him in all capacities for six months for having violated NASD Conduct Rules 2310 and 2110 by making unsuitable recommendations to the Downers and the Landrys. The Sanction Guidelines recommend a fine of $2,500 to $75,000 and a suspension of ten business days to one year or, in egregious cases, a suspension of up to two years or a bar.[38] The suspension and fine are within this range.

NASD found aggravating that Siegel attempted to conceal his misconduct from his employer, that his misconduct resulted directly in injury to the Downers and the Landrys, and that his misconduct carried the potential for monetary or other gain.

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[36] *Hartley*, 57 S.E.C. at 776.

[37] *See Anthony H. Barkate*, 57 S.E.C. 488, 501 & n.28 (2004) (citing *Ronald W. Gibbs*, 52 S.E.C. 358, 365 (1995)), *petition denied*, 125 Fed. Appx. 892 (9th Cir. 2005).

[38] Sanction Guideline at 99.

NASD also found aggravating that Siegel's misconduct was the result of recklessness. We agree.[39] At the time of the conduct at issue, Siegel was a securities professional with over seventeen yea experience. Yet, he testified that he neither read nor discussed with the Downers and the Landrys the contents of any of the World IEQ and World ET documents that he provided to them. He admitted at the hearing that these documents were deficient and that these deficiencies rendered an investment in World IEQ and World ET unsuitable for any investor.

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[39] *Cf.* Restatement (Third) Of Torts § 2 (Proposed Final Draft 2005) ("A person acts recklessly in engaging in conduct if: (a) the person knows of the risk of harm created by the conduct or knows facts that make the risk obvious to another in the person's situation, and (b) the precaution that would eliminate or reduce the risk involves burdens that are so slight relative to the magnitude of the risk as to render the person's failure to adopt the precaution a demonstration of the person's indifference to the risk."); Oliver Wendell Holmes, The Common Law 135-26 (1881) ("The question is, what known circumstances are enough to throw the risk of a statement upon him who makes it, if it induces another man to act, and it turns out untrue. . . . Now what does 'recklessly' mean. It does not mean actual personal indifference to the truth of the statement. It means only that the data for the statement were so far insufficient that a prudent man could not have made it without leading to the inference that he was indifferent. That is to say, . . . it means that the law, applying a general objective standard, determines that, if a man makes his statement on those data, he is liable, whatever was the state of his mind, and although he individually may have been perfectly free from wickedness in making it.")

In response to NASD's finding that he acted recklessly, Siegel claims that he did not act with fraudulent intent. However, Principal Consideration Number Thirteen under the Sanction Guidelines directs adjudicators to consider in all cases "[w]hether the respondent's misconduct was the result of an intentional act, recklessness or negligence." The applicability of this factor is not limited to proceedings involving fraud violations.[40]

Siegel argues that the "NAC's decision to jettison the Hearing Panel's credibility determination regarding his intent violates the rule of deference to fact-finders," and that the Hearing Panel's finding that he acted negligently "may be overcome only where the record contains substantial evidence for doing so." Siegel's arguments are without merit. The Hearing Panel did not make a credibility determination when it found that Siegel acted negligently. Thus, Siegel's state of mind and its mitigative effect are subject to the NAC's and our *de novo* review.[41] The record provides ample support for finding that Siegel acted

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[40] *See generally Robert E. Strong*, Exchange Act Rel. No. 57426 (Mar. 4, 2008), _ SEC Docket _ (considering whether chief compliance officer acted negligently or intentionally in allowing defective disclosures in research reports); *Hans N. Beerbaum*, Exchange Act Rel. No. 55731 (May 30, 2006), 90 SEC Docket 1863 (considering whether owner and president of member firm acted intentionally in engaging in conduct requiring registration as a general securities principal without being so registered).

[41] *See supra* notes 18 and 19.

recklessly in making the unsuitable recommendations.

3. Siegel's Mitigation Claims

Siegel argues, as he did before the NAC, that there are a number of mitigating factors that justify a reduction in the sanctions imposed by NASD. We have discussed several of Siegel's assertions above and found them not supported. The remaining asserted mitigating factors fall into two general categories.

a. Siegel asserts that NASD improperly ignored "mitigating factors by considering them merely as 'non-aggravating.'" However, Siegel has failed to establish that the following group of factors, even if true, provides any mitigation. Siegel argues that his violation of NASD Conduct Rule 3040 "stemmed from his misunderstanding of it." We repeatedly have held that an associated person is obligated to be familiar with NASD's rules and ignorance of the requirements at issue is no excuse.[42] Siegel's claimed misunderstanding of his obligation to comply with Conduct Rule 3040 is especially not mitigating because of his seventeen years of experience as an associated person in the securities industry and the fact that he has been active as a registered investment advisor,

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[42] *See Prime Investors, Inc.*, 53 S.E.C. 1, 5 & n.12 (1997) (finding a claim ignorance of the law not mitigating).

authored a book on investment advice, and served as a local media expert on financial topics.[43]

Siegel also asserts that he has no disciplinary history and that he cooperated in NASD's investigation. These facts are not mitigating because when Siegel registered with NASD, he agreed to abide by its rules, and compliance with this obligation is not a mitigating factor.[44]

Siegel asserts that he never performed any act pursuant to the World ET employment agreement, that the World ET securities have not been found to involve a violation of federal or state securities laws or federal, state, or self-regulatory organization rules, that he did not attempt to create the impression that

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[43] *Cf. Keyes,* 89 SEC Docket at 800 & n.18 (finding that associated person's claimed ignorance of his obligations regarding NASD Conduct Rule 3040 to be aggravating in light of his fifteen years of experience in the securities industry and the fact that he previously taught a preparatory class for the Series 6 qualification examination).

[44] *See Michael A. Rooms,* Exchange Act Rel. No. 51467 (Apr. 1, 2005), 85 SEC Docket 444, 450-51 (finding sanction neither oppressive nor excessive where respondent noted a lack of disciplinary history), *aff'd,* 444 F.3d 1208, 1214 (10th Cir. 2006); *Keyes,* 89 SEC Docket at 801 & nn. 20, 22 (finding cooperation during NASD investigation and a lack of disciplinary history not mitigating) (citing cases); *Michael Markowski,* 51 S.E.C. 553, 557 (1993), *aff'd,* 34 F.3d 99 (3d Cir. 1994). The Guidelines provide that an associated person's "substantial assistance" to NASD during an investigation is generally mitigating. Siegel's cooperation was consistent with the responsibility he agreed to fulfill when he became an associated person and does not constitute substantial assistance.

Rauscher sanctioned the activity, and that he did not recruit other registered individuals to sell World ET securities. While the presence of any of these factors could constitute aggravating circumstances justifying an increase in sanctions, their absence is not mitigating. This is because an associated person should not be rewarded for acting in compliance with the securities laws and with his duties as a securities professional.[45]

b. NASD did find certain factors mitigating. Siegel argues that his recommendations were neither numerous nor made over an extended period of time, that the Downers and Landrys were "comparatively sophisticated persons who knew that they were risking money on a start-up enterprise with a new product," that a small number of customers were involved in the sales at issue, and that he disclosed to his customers that he was seeking an appointment to World ET's board. We agree with NASD that the mitigating impact of these factors is outweighed by the aggravating factors, especially given Siegel's failure to take steps to determine if investing in World ET was suitable for any investor.

Accordingly, we find that the mitigating factors raised by Siegel do not support a reduction in the sanction imposed by NASD.

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[45] *See Keyes*, 89 SEC Docket at 801 & n.20.

4. Consecutive Suspensions

NASD ordered Siegel to serve the two six-month suspensions consecutively. In making this determination, NASD stated that "the purpose of sanctions in NASD disciplinary proceedings is to remedy misconduct" and that "in cases involving rule violations of fundamentally different natures, consecutive suspensions specifically discourage all types of additional misconduct at issue." NASD noted that "consecutive suspensions might exceed what is needed to be remedial, depending on the facts and circumstances." NASD suggested that, where the underlying violations involved wholly unintentional or negligent conduct and similar violations resulted from the same underlying conduct, concurrent suspensions "might be enough to alert such a respondent about his various regulatory responsibilities and deter him from again engaging in the same kinds of violative conduct."[46] However, NASD concluded that consecutive suspensions were necessary to discourage Siegel's misconduct "because his selling away and suitability violations involve different kinds

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[46] General Principle Four of the Sanction Guidelines also discusses when the aggragation or "batching" of violations may be appropriate if (a) the violative conduct was unintentional or negligent; (b) the conduct did not result in injury to public investors; or (c) the problem resulted from a single systemic problem or cause that has been remedied. General Principle Four also states that multiple violations may be treated individually "[d]epending on the facts and circumstances of a case."

of misconduct and raise separate and serious regulatory concerns."

Siegel argues that the imposition of consecutive suspensions is punitive because his violations involved the "same underlying conduct" and should therefore have resulted in "batching," or concurrent suspensions. We have not previously addressed whether the imposition of consecutive – as opposed to concurrent – suspensions is excessive or oppressive. We agree with NASD that Siegel's violations are different in nature and raise separate public interest concerns. The purpose of NASD Conduct Rule 3040 is to protect "investors from unsupervised sales and securities firms from exposure to loss and litigation from transactions by associated persons outside the scope of their employment."[47] The suspension will protect the public interest by discouraging Siegel and others from selling away and from undermining the protections in place at firms.[48] In contrast, the purpose of the suitability rule is to protect customers from potentially abusive sales practices by ensuring that a registered representative has reasonable grounds for believing that his recommendation is suitable.[49] The second suspension will protect the

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[47] *See Hartley*, 57 S.E.C. at 775 n.17 (citation omitted).

[48] *See Hartley*, 57 S.E.C. at 776 (affirming suspension for violation of NASD Conduct Rule 3040).

[49] *See Self-Regulatory Organizations; NASD; Order Granting Approval to Proposed Rule Change*, Exchange Act Rel. No. 37588 (Aug. 20, 1996), 62 SEC Docket 1784, 1795 ("The concept of

(Continued on following page)

public interest by encouraging Siegel and others to take the steps necessary to determine that recommendations that they make to their customers are suitable while also deterring them from putting their own interests ahead of those of their customers.[50] Under the circumstances and with due regard for the public interest and the protection of investors, we find that NASD's imposition of two consecutive six-month suspensions with respect to the violations found here does not exceed what is needed to be remedial and therefore is not excessive or oppressive.[51]

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Accordingly, we find that the suspensions and fines serve a remedial purpose and that Siegel has failed to identify any mitigating factors that support a reduction in these sanctions.

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suitability, rooted in notions of just and equitable principles of trade and the protection of investors, plays an important role in the scheme of the federal securities laws. Prohibitions against making unsuitable recommendations . . . lay the foundation for good and sound business practices by broker-dealers and help avoid potential abusive sales practices regarding customers.")

[50] *Cf. McNabb*, 54 S.E.C. at 928 & n.41 (1999) (finding that associated person put his own interests ahead of those of his customers by making unsuitable recommendation that they purchase promissory notes to give him money to use in his business).

[51] *See PAZ Sec., Inc.*, Exchange Act Rel. No. 57656 (Apr. 11, 2008), _ SEC Docket (finding sanction to be remedial and therefore neither excessive nor oppressive), *appeal docketed*, No. 08-1188 (D.C. Cir. May 13, 2008).

B. Restitution

NASD ordered restitution to the customers at issue in the amount of $400,300. Siegel attempts to import common law equity principles to an analysis of NASD's restitution award. However, NASD's authority to order restitution arises not from common law but from its power to impose "any other fitting sanction."[52] As a result, Siegel's contentions with respect to judicially assessed restitution are inapposite.

For example, Siegel argues that an award of restitution is inappropriate because he did not cause the customers' losses but only caused them to invest. Siegel relies on *Bastian v. Petren Resources Corp.*[53] However, *Bastian* was a private action for damages under the antifraud provisions of the federal securities laws where "loss causation" was an element of the claim.

In contrast, we have stated that self-regulatory organization "[r]estitution is founded on the principle that a wrongdoer shall not be unjustly enriched by his wrongdoing, or that the wrongdoer should restore his victim to the status quo ante."[54] To that end, we have expressed "our preference that the NASD issue orders of restitution, in contrast to fines payable to

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[52] NASD Rule 8310(6), NASD Manual at 7271.

[53] 892 F.2d 680 (7th Cir. 1990).

[54] *Toney L. Reed*, 51 S.E.C. 1009, 1013 & NN.15, 16 (1994) (citing RESTATEMENT OF RESTITUTION § 1 (1937)); *see also David Joseph Dambro*, 51 S.E.C. 513, 518 (1993).

the NASD, in instances in which losses have been suffered by identifiable customers *as a result* of a respondent's misconduct."[55] Our decision in *David Joseph Dambro*[56] anticipated the possibility that, under certain circumstances, restitution may be an appropriate remedy where an identifiable person has suffered a loss as a result of a registered representative's recommendation. As we stated in *Dambro*,[57] as between Siegel's customers, who were placed in unsuitable investments and Siegel, who recommended them, equity requires Siegel, as the person responsible for the losses, to bear their burden and to return the customers to the position occupied prior to the unsuitable recommendations. The current Sanction Guidelines recommend restitution "where necessary to remediate misconduct" and when an identifiable

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[55] *Toney L. Reed*, 52 S.E.C. 944, 946 & n.11 (1996) (emphasis added) (citing *Dambro*, 51 S.E.C. at 518-19). In requiring that a loss be *a* result rather than *the* result of a respondent's misconduct, we acknowledge that other factors may bear upon the loss and that any determination as to the propriety of restitution will be based on an analysis of all the relevant facts and circumstances.

[56] 51 S.E.C. 513 (1993).

[57] 51 S.E.C. at 518-19 ("As between Wiegman, who was placed in an unsuitable investment and Dambro, who recommended it, equity requires Dambro, as the person responsible for the loss, to bear its burden and to return the customer to the position occupied prior to the improper recommendation.").

person "has suffered a quantifiable loss as a result of a respondent's misconduct."[58]

Here, Siegel introduced the Downers and the Landrys to World ET, recommended without any basis that they invest in the company, was their sole source of information about the company prior to making their investment decisions, and facilitated their purchases of World ET securities. Given that Siegel was the first to identify World ET to the customers and the significance of Siegel's involvement and influence in the decision of the customers to invest in World ET, we conclude that the customers' losses were a result of his recommendations. We therefore reject Siegel's argument.

Siegel argues that restitution is not appropriate because he received no monetary gain. We have repeatedly stated, however, that restitution does not require that an applicant have profited or benefitted from his actions.[59] Sanction Guidelines General Principle Five also provides that NASD orders of

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[58] Sanction Guidelines at 4 ("Adjudicators may order restitution when an identifiable person, member firm or other party has suffered a quantifiable loss as a result of a respondent's misconduct, particularly where a respondent has benefitted from the misconduct."); *see also Wendell D. Belden*, 56 S.E.C. 496, 507 (2003).

[59] *See Franklin N. Wolf*, 52 S.E.C. 517, 526 (1995); *Toney L. Reed*, 51 S.E.C. at 1013-14.

restitution may exceed the amount of the respondent's ill-gotten gain.[60]

Siegel asserts that the customers should not receive restitution because they knew the risks associated with their investment and were sophisticated. As a result, Siegel claims that he did not cause their losses. Even where a customer seeks to engage in a highly speculative investment, a registered representative has a duty to refrain from making unsuitable recommendations.[61] Siegel did not satisfy this duty. Instead, he made reckless recommendations to customers who relied on his financial advice.

Siegel claims that the Downers and the Landrys are guilty of laches and violation of the statute of limitations. He asserts that they delayed in bringing an arbitration against Siegel, which, in turn, delayed the initiation of the current proceeding. Siegel also claims the customers are guilty of unclean hands because Huntington Downer's law firm threatened Siegel with criminal prosecution. However, the party in this proceeding is NASD, not the customers. Whether the customers were estopped by laches or a statute of limitations from pursuing an arbitration proceeding does not affect NASD's ability to discipline

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[60] Sanction Guidelines General Principle Five.

[61] *See Jack H. Stein*, 56 S.E.C. 108, 113 & n.14 (2003) (finding that a registered representative is under a duty to refrain from making unsuitable recommendations even where a customer affirmatively seeks to engage in highly speculative trading) (citations omitted).

associated persons of its members, including imposing a "fitting sanction" for that person's wrongful conduct.

Siegel argues that he was prejudiced by the alleged delay because he was unable to call three now deceased or ill customers who would have testified that Siegel had not recommended World ET securities to them. This testimony, however, has no bearing on whether Siegel recommended World ET securities to the Downers and the Landrys.[62] This testimony also would not mitigate Siegel's misconduct with respect to the Downers and Landrys.[63] Siegel also claims that he was unable to produce certain records but does not identify the substance or relevance of those records. Thus, Siegel has not demonstrated that he suffered any prejudice.

Siegel claims that NASD acted unfairly when it failed to hold an in-person hearing regarding whether the restitution amount required offset. Siegel does not dispute that there is no offset under the three factors set forth by the NAC, i.e., the Downers and the Landrys did not sell their investments in World

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[62] *Cf. Gluckman*, 54 S.E.C. at 190-91 (finding that applicant suffered no prejudice from inability to examine witness during an NASD hearing due to passage of time where testimony of the witness would not have a had a material effect on the proceeding).

[63] *Cf. Dane S. Faber*, 57 S.E.C. 297, 313 n.33 (2004) (finding that failure to engage in other violative conduct did not mitigate violations at issue); *Richmark Capital Corp.*, 57 S.E.C. 1, 18 (2003) (finding that failure to engage in misconduct "that was arguably more serious" did not mitigate violations at issue).

securities, their World securities have no residual value, and they recovered no restitution through other avenues. Yet, Siegel contends that an in-person hearing was required so that he could present evidence of the "customers' expectations [of recovery and] measures of their reasonable expectations" and demonstrate the prejudice that he allegedly suffered due to the customers' purported "undue delay in . . . voicing complaint." However, this evidence goes to whether restitution was an appropriate sanction, a determination that had been resolved in the initial in-person hearing at which Siegel had the opportunity to, and did, examine and cross-examine witnesses and present evidence. While Siegel also contends that an in-person hearing was required so that he could cross-examine the affiants, it is unclear what purpose cross-examination would have served, because Siegel did not dispute the affiants' testimony that there was no offset to the restitution award.[64]

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[64] We are unpersuaded by Siegel's citation to *SEC v. Smyth*, 420 F.3d 1225 (11th Cir. 2005), in support of his argument that an evidentiary hearing was required. In *Smyth*, the court acknowledged that an evidentiary hearing is not always required to determine the appropriate amount of a sanction. It found that, under the particular circumstances of the case, the trial court improperly denied an evidentiary hearing because the appellant had explicitly reserved in a written settlement agreement the right to litigate the amount of disgorgement and prejudgment interest, which had not yet been determined and could potentially have amounted to zero if certain of the appellant's claims about the undetermined amount were true. Such circumstances do not exist here.

Siegel complains that the NAC increased his sanctions when it ordered restitution where the Hearing Panel did not, rendering this aspect of the sanction determination punitive and unfair. Here, the NAC found that the Hearing Panel improperly concluded that the pending arbitration proceeding foreclosed restitution. We have stated that the "NASD procedural rules expressly permit the NAC, where appropriate, to 'affirm, modify, reverse, increase, or reduce any sanction, or impose any other fitting sanction.'"[65]

On the basis of the record in this proceeding, we do not find these sanctions either excessive or oppressive.

An appropriate order will issue.[66]

By the Commission (Chairman COX and Commissioners CASEY and PAREDES), Commissioners WALTER and AGUILAR not participating.

/s/ Florence E. Harmon
Florence E. Harmon
Acting Secretary

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[65] *See Abbondante*, 87 SEC Docket at 224 & n.71 (citing NASD Code of Procedure Rule 9348, NASD Manual at 7371).

[66] We have considered all of the arguments advanced by the parties. We have rejected or sustained them to the extent that they are inconsistent or in accord with the views expressed in this opinion.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 58737 / October 6, 2008

Admin. Proc. File No. 3-12659

In the Matter of the Application of

MICHAEL FREDERICK SIEGEL
c/o George C. Freeman, III
Barrasso Usdin Kupperman
Freeman & Sarver, LLC
909 Poydras Street, Suite 2400
New Orleans, Louisiana 70112

For Review of Disciplinary Action Taken by

NASD

ORDER SUSTAINING DISCIPLINARY ACTION TAKEN BY REGISTERED SECURITIES ASSOCIATION

On the basis of the Commission's opinion issued this day, it is

ORDERED that the disciplinary action taken by NASD against Michael Frederick Siegel, and NASD's assessment of costs be, and they hereby are, sustained.

By the Commission.

/s/ Florence E. Harmon
Florence E. Harmon
Acting Secretary